Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

No.

In the Supreme Court of the United States

UNITED STATES OF AMERICA, EX REL.
DAN GRAVES; SUSAN NEWMAN,
Petitioners,

v.

ITT EDUCATIONAL SERVICES, INC.;
PRICEWATERHOUSECOOPERS LLP,
Respondents.

UNITED STATES OF AMERICA, EX REL.
JAMES F. BOWMAN,
Petitioner,

v.

EDUCATION AMERICA, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Under the Higher Education Act, proprietary (for-profit) schools can participate in the Government guaranteed student loan and the Pell Grant programs on the condition that they pay no commission, bonus, or other form of incentive compensation to recruiters based directly or indirectly on the number students they enroll. 20 U.S.C. § 1094 (a)(20). **Did the Fifth Circuit violate the Appropriations Clause in holding that the recruiter compensation ban cannot support a False Claims Act suit as a matter of law because the statute fails to state explicitly that compliance is a condition of payment by the Government?**

2. An additional statutory condition of eligibility requires every proprietary school to submit a compliance examination and an audited financial statement each year to the U.S. Department of Education. The audits and examinations must be performed by public accountants and must attest to the school's compliance with the Higher Education Act program requirements and the school's financial standing. 20 U.S.C. § 1094(c). **Are public accountants liable under the False Claims Act for their false statements contained in statutorily required compliance examinations and audited financial statements?**

The ITT decision turns the Appropriations Clause of the Constitution completely on its head by allowing ineligible recipients of Government funds to escape repayment whenever Congress fails to explicitly identify which

obligations are "conditions of payment". The decision rests on the artificial distinction between conditions of payment versus conditions of participation for purposes of FCA liability. The rule adopted by the Fifth Circuit is that the statutory requirements for receiving federal money set forth in a Congressional appropriation are unenforceable in a False Claims Act suit unless Congress explicitly has explicitly stated that the statutory requirement is a condition of payment. As a result, the Government loses its False Claims Act remedy unless it reserves it in a statute. The Appropriations Clause and False Claims Act remedies are subverted based on the distinction between conditions of payment and conditions of participation. The ruling will open the flood gate of litigation when Government funds are in dispute.

PARTIES TO THE PROCEEDING

Pursuant to Rule 12.4 of this Court, two judgments are sought to be reviewed on a writ of certiorari to the same court that involve identical or closely related issues. Both the district and circuit courts in *United States ex rel. James F. Bowman v. Education America, Inc.* expressly relied on *U.S. ex rel Graves v. ITT Educational Services, Inc.*, 284 F. Supp.2d 487 (S.D. Tex. 2003) as the basis for decision.

Petitioners in the ITT case are: United States of America *ex rel.* Dan Graves and Susan Newman.

Respondents in the ITT case are: ITT Educational Services, Inc., a Delaware corporation; PricewaterhouseCoopers LLP; Rene R. Champagne.

Petitioners in the Education America case are: United States of America *ex rel.* James F. Bowman.

Respondents in the Education America case are: Education America, Inc.; Jerald M. Barnett, Jr.; Pedro De Guzman; Erin J. Hinkle; Karon J. Rosa; Bob Seeley; Suzette Goodman.

Pursuant to Rule 29.6 of this Court's rules, Petitioners state as follows:

ITT Industries, Inc. is a publicly held company, and was the sole owner, and later, the beneficial owner of more than 10% of the outstanding shares of respondent ITT Educational Services, Inc.

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OPINIONS BELOW

The March 31, 2003 Opinion and Order of the United States District Court for the Southern District of Texas is reported at *United States of America, ex rel. Graves et al. v. ITT Educational Services, Inc.*, 284 F. Supp.2d 487 (S.D. Tex. 2003). App. 5. The October 20, 2004 Opinion of the Fifth Circuit Court of Appeals on the merits is unreported. App. 3. The petition for panel rehearing and rehearing en banc was denied on November 18, 2004. App. 1.

The January 8, 2004 Memorandum and Order of the United States District Court for the Southern District of Texas in *United States of America ex rel. James F. Bowman v. Education America, Inc., et al.* is unreported. App. 55. The November 30, 2004 Opinion of the Fifth Circuit Court of Appeals is unreported. App. 6. No petition for rehearing was filed in *Education America*.

JURISDICTION

The United States Court of Appeals for the Fifth Circuit entered its decision denying the petition for rehearing en banc in the ITT case on November 18, 2004. The Fifth Circuit decision in the Education America case was entered on November 30, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) to review the circuit court's decisions on a writ of certiorari.

RELEVANT PROVISIONS

This case involves the False Claims Act, 31 U.S.C. 3729-3733. Section 3729 is set out in Petitioner's Appendix at App. 61.

Article I, section 9, clause 7 the Constitution provides:

"No money shall be drawn from the Treasury, but in consequence of appropriations made by law."

The Higher Education Act, 20 U.S.C. 1094(a)(20), provides:

"1094. Program participation agreements

(a) Required for programs of assistance; contents. In order to be an eligible institution for the purposes of any program authorized under this title, an institution must be an institution of higher education or an eligible institution (as that term is defined for the purpose of that program) and shall ... enter into a program participation agreement with the Secretary. The agreement shall condition the initial and continuing eligibility of an institution to participate in a program upon compliance with the following:

* * *

(20) The institution will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance, except that this paragraph shall not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Federal student assistance."

The Higher Education Act, 20 U.S.C. § 1094(c) provides, in part:

"(c) Audits; financial responsibility; enforcement of standards.

(1) Notwithstanding any other provisions of this title, the Secretary shall prescribe such regulations as may be necessary to provide for–

(A) (i) except as provided in clauses (ii) and (iii), a financial audit of an eligible institution with regard to the financial condition of the institution in its entirety, and a compliance audit of such institution with regard to any funds obtained by it under this title or obtained from a student or a parent who has a loan insured or guaranteed by the Secretary under this title, on at least an annual basis and covering the period since the most recent audit, conducted by a qualified, independent organization or person in accordance with standards established by the Comptroller General for the audit of governmental organizations, programs, and functions, and as prescribed in regulations of the Secretary, the results of which shall be submitted to the Secretary and shall be available to cognizant guaranty agencies, eligible lenders, State agencies, and the appropriate State agency notifying the Secretary under subpart 1 of part H [20 USCS §§ 1099a et seq.];"

Title 31 U.S.C. § 3711(b)(1) provides in relevant part:

"The head of an executive, judicial, or legislative agency may not act . . . on a claim that appears to be fraudulent, false, or misrepresented by a party with an interest in the claim...."

STATEMENT OF FACTS

(i) Eligibility requirements

The Higher Education Act ("HEA") requires every institution to enter into a Program Participation Agreement ("PPA") with the U.S. Department of Education ("DeptEdu") in order to receive program funding. The PPA must recite verbatim the statutory language that prohibits the school from paying incentive compensation to its recruiters.[1] Each PPA states that execution of the agreement is a "prerequisite" to participation in the programs.[2]

The HEA also requires institutions to file a compliance examination and an audited financial statement with the DeptEdu. The audit and examination are prerequisites to the school's initial and continued eligibility to receive program funds, and retain funds already received. The audit and examination are conducted by public accountants.[3] The accountants must report to the DeptEdu whether the school has "paid to any person or entities any commission, bonus, bonus, or other incentive payment based directly or indirectly on success in securing enrollments, financial aid to students,

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[1] 20 U.S.C. § 1094(a)(20).

[2] "The execution of this Agreement by the Institution and the Secretary is a prerequisite to the Institution's initial and continued participation in any Title IV, HEA Program."

[3] *See,* 20 U.S.C. §§ 1094(c); 1099c; 34 CFR § 668.23.

or student retention [34 CFR 668.14(b)(22)]" under the *SFA Audit/ Attestation Guide*[4]. (brackets in original) (R. 2:1241).

(ii) Facts of the case

ITT is a publicly traded company that operates sixty-eight (68) proprietary schools in various cities throughout the United States. ITT was wholly owned by ITT Industries, Inc., and taken public in 1994. More than 70% of ITT's revenues came from Government guaranteed student loans and Pell Grants made to its students from 1994-2000. Respondent Rene R. Champagne is president of ITT. During that time, ITT executed eighty-seven (87) PPAs, each of which recited verbatim the statutory recruiter compensation prohibition.

During this period, ITT paid its recruiters "5% of earned revenues for Inside Representatives and 10% of earned revenues for Outside Representatives." ITT also had minimum enrollment quotas for its recruiters. As of December 31, 1998, ITT employed approximately 255 recruiters at its campus admissions offices. Another 255 recruiters worked outside these offices directly contacting high school seniors and other prospective students. Relators Dan Graves and Susan Newman were employed as inside recruiters at the Santa Clara, California campus of ITT. All enrollments and all HEA funds ITT received from 1994-2000 were generated while ITT was engaging in these incentive compensation practices with its recruiters.

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[4] *General Audit (Attestation) Guide of Federal Student Assistance Programs at Participating Institutions* (June 1995) promulgated by the U.S. Department of Education's Office of Inspector General.

PW conducted ITT's compliance examinations and audited ITT's financial statements. In addition, PW prepared ITT's Forms 10-K (annual reports) filed with the Securities & Exchange Commission ("SEC"). PW made contradictory representations to the DeptEdu and the SEC regarding ITT's compliance with the recruiter compensation statute. PW reported to the SEC that ITT's compliance with the recruiter compensation prohibitions was *unclear*. At the same time, PW certified to the DeptEdu that ITT was in full compliance "in all material respects" with the Higher Education Act requirements. PW concealed ITT's recruiter compensation practices from the DeptEdu. PW failed to blow the whistle to the DeptEdu, the very federal agency to which its compliance report was issued. The Government paid hundreds of millions of dollars in student federal aid to ITT based on the assurances and attestations made by PW.

The complaint asserts that respondents' violations of the HEA are actionable under 31 U.S.C. §§ 3729(a)(1) (presenting false claims for payment); (a)(2) (making false statements to get false claims paid or approved); (a)(3) (conspiring to present false claims); and (a)(7) (false statements to conceal or decrease an obligation to repay the Government) of the FCA. (R. 4:742). Petitioner seeks recovery of all defaulted loans paid by the Government, all interest paid by the Government on all insured loans, all Pell Grants, and all other Title IV, HEA Program funds paid by the Government to students who enrolled and attended ITT while the company was in violation of the recruiter compensation prohibition.

(iii) Proceedings Below

This action was instituted as a *qui tam* proceeding under the False Claims Act, 31 U.S.C. §§ 3729-3733, alleging the

presentation of false claims by defendants under Title IV of the Higher Education Act. Relators asserted jurisdiction and venue of the action under 28 U.S.C. § 1345 and 31 U.S.C. § 3732(a). Relators initiated the action against respondents ITT and PW by filing a complaint *in camera* and under seal. (R. 6:14). While the case was under seal, relators filed the first amended complaint joining Rene R. Champagne as an additional defendant. (R. 6:41). The United States elected to decline to intervene. (R. 6:64). The district court ordered the file unsealed, and the case proceeded. (R. 6:71).The district court stayed all discovery at the request of defendants.

Defendants moved to dismiss relators' first amended complaint. (R. 6:314; R. 6:109). The district court granted the motion to dismiss on the grounds that relators had not alleged that the violations were "material" as required under Fifth Circuit jurisprudence, and relators were granted leave to amend their complaint at that time. (R. 4:696). Relators duly filed their second amended complaint alleging that the recruiter compensation prohibition in the HEA was material as a matter of law under the Appropriations Clause. (R. 4:742). Defendants filed their motions to dismiss for failure to state a claim. (R. 4:875; R. 4:906).

The U.S. Department of Justice filed a statement of interest in the district court in support of relators' FCA causes of action against both ITT and PW. (R. 2:1494).

On March 31, 2003, the district court granted defendants' motion to dismiss. (R. 1:1571), and signed a final judgment dismissing the action with prejudice. (R. 1:1572). The district court did not grant relators leave to amend their complaint, although leave had been requested. Appeal to the Fifth Circuit followed. (R. 1:1576). Oral argument was held before the Fifth Circuit on October 4, 2004. Two weeks

later, on October 20, 2004, the Fifth Circuit affirmed the district court in a per curiam decision.

The U.S. Department of Education entered into a settlement agreement with ITT, and fined the company $230,000 relating to the recruiter compensation violations. The agreement expressly states, however, that the Agency is has no authority to settle False Claims Act suits.[5]

REASONS FOR GRANTING THE WRIT

I. Public accountants must have liability to the Government under the False Claims Act

Unless public accountants are held liable for the misrepresentations they make to the Government about their clients, most federal government programs will either go completely unregulated, or the cost of policing program recipients will drive the program costs beyond the Government's ability to fund them. The reason Congress adopted the requirement for compliance examinations and financial statement audits was because the DeptEdu was determined to be incapable of policing the student financial aid programs following two Congressional investigations. The HEA was passed in 1964. By 1975, Congress launched its first investigation into wide scale fraud in the Title IV, HEA Programs by the proprietary school industry. The

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[5] "G. The Department does not have authority to, and this Agreement does not, waive, compromise, restrict or settle any past, present or future violations by ITT, its trustees, officers or employees of the criminal laws of the United States or any action initiated against ITT, its trustees, officers or employees for civil fraud against the United States under 31 U.S.C. §§ 3729-33."

Senate conducted a second, two-year investigation of the proprietary school industry in 1991. "The Subcommittee investigation uncovered overwhelming evidence that the GSLP, particularly as it relates to proprietary schools, is riddled with fraud, waste, and abuse, and is plagued by substantial mismanagement and incompetence."[6] Congress determined that the DeptEdu is incapable of overseeing the Title IV, HEA Programs.[7] "[T]he system is so fundamentally

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[6] 102 S. Rpt. 58 (1991), *Abuses In Federal Student Aid Programs ("Senate Report")*.

[7] Senator Sam Nunn remarked that the DeptEdu was incapable of policing the schools, and that most of the Government funds were being used to pay off defaulted loans.

> In short, we have now reached the sad point where program funds are primarily being used not to subsidize education and training and skills for today's students, but rather to pay off bad loans from the past....
>
> With the above in mind, let me comment on the one factor that has surfaced at every level of these programs and, as such, throughout our entire investigation, and that is the role of the Department of Education itself. In brief, it is not an exaggeration to say that we have heard no testimony or seen any documents that suggest the Department has done even an adequate job in managing and overseeing its student loan program responsibilities.
>
> Moreover, criticism of the Department's efforts in this area is not unique to this investigation. Way back in 1975, this same Subcommittee heard testimony on student loan programs that was disturbingly similar, although in much

rotten that it simply does not and perhaps cannot keep up with uncovering all the bad actors." *Senate* Report at 12. "[A] virtually complete breakdown in effective regulation and oversight had opened the door for fraud, abuse, and other serious problems at every level." *Senate Report* at 13.

PW acknowledged beforehand that it intended for the DeptEdu to rely on its audit reports. Each audit report stated: "[t]his report is intended solely for the information of the audit committee, management, and the U.S. Department of Education." In addition, each audit engagement contract between ITT and PW contained an express "statement that both parties understand that ED intends to use the IPA's [independent public accountant] report to help carry out its oversight responsibilities of the Title IV programs."[8] A duty to disclose arises when the accountants' opinions are filed

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> smaller volumes back then, to that which we have heard in these hearings. The General Accounting Office over a period of many years has also repeatedly brought many of these problems to the Department's attention. Despite all of that, the programs failures seem only to have gotten worse, as default volume and cost to taxpayers have skyrocketed.

Abuses In Federal Student Aid Programs: Hearing Before the Permanent Committee On Investigations of the Senate Committee On Governmental Affairs, S. Hrg. 101-659, Pt. 4 at 4.

[8] This language is required by the *SFA Audit/ Attestation Guide*.

pursuant to Government reporting requirements.[9] PW's duty to the Government was to examine and report to the Government whether the program requirements were being adhered to. These were statutory audits[10]. Accountants are considered the "public watchdog."[11] Their audits and examinations carry important consequences for the Government.

II. The recruiter compensation ban is an important protection for students and for the Government fisc

The Fifth Circuit decision nullifies the recruiter compensation ban in the Higher Education Act. Congress considered the prohibition important enough to require that the statutory language be included in the Government's agreements with every single proprietary school that receives federal student financial aid. The Fifth Circuit decision leaves the Government without any remedy to recover the losses sustained from violation of the statute. The DeptEdu is without jurisdiction to pursue the funds paid to recipients who directly violate the Higher Education Act as stated in its settlement agreement between the agency and ITT.

There is a strong national interest in the success of the Higher Education Act student financial aid programs. Congress determined that the intended beneficiaries of the

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[9] *Herman & McClean v. Huddlesten,* 459 U.S. 375, 378 (1983).

[10] 20 U.S.C. §§ 1094(c) and 1099c(c)

[11] *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984)).

Higher Education Act financial aid programs — the students — were being left with huge debts they could not repay as the result of unscrupulous recruiting practices. Since the defaulted student loans are debts to the Government, the Bankruptcy Code does not permit their discharge. The long term social ills created by the student debt burdens was considered of critical importance to the Senate Subcommittee:

> Fraud and abuse in the GSLP have had perhaps the most profound and disastrous effect on the intended beneficiaries of the Federal student aid the students. The Subcommittee heard testimony that unscrupulous and dishonest school operators victimize students, leaving them with huge debts and little or no education.[12]

The Fifth Circuit's new distinction between conditions of participation and conditions of payment as the basis for determining whether conditions imposed by Congress are actionable under the False Claims Act subverts the Appropriations Clause of the Constitution.[13] The Fifth Circuit's new requirement, namely that statutes which set forth the conditions for receiving money from the U.S. Treasury must explicitly state that compliance is a condition of payment in order to be actionable under the FCA, creates an almost insurmountable obstacle to the Government's collection of federal dollars paid to ineligible recipients under existing contracts and statutes. This Court has always

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[12] *Senate Report.*

[13] "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." Art. I, § 9, cl. 7.

employed "a most strict approach" to question of expenditure of public funds contrary to statutory authority.[14]

III. The ITT decision will seriously interfere with Government efforts to collect money obtained by fraud across a vast number of Government programs and contracts.

The decision eviscerates the Government's right to collect money on all contracts where the "condition of payment" language is missing, and will undermine the Government's ability to collect payment inade to ineligible recipients across an untold number of Government programs and contracts. The False Claims Act is the Government's remedial statute.[15] The exclusive authority to adjudicate False Claims Act and fraud claims rests with the Department of Justice and the Attorney General.[16] The False Claims Act expands the Government's remedies by authorizing relators to bring *qui tam* actions on behalf of the United States Government.[17]

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[14] *OPM v. Richmond*, 496 U.S. 414, 426 (1990) (For example, "not a single case has upheld an estoppel claim against the Government for the payment of money."). *Id.* at 427.

[15] H.R.Rep. No. 99-660, p18 (1986) ("[T]he False Claims Act is used as ... the primary vehicle by the Government for recouping losses suffered through fraud").

[16] 31 U.S.C. § 3711(b)(1) ("The head of an executive, judicial, or legislative agency may not act . . . on a claim that appears to be fraudulent, false, or misrepresented by a party with an interest in the claim....")

[17] 31 U.S.C. § 3730(b)(1); *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765 (2000).

The assertion in ITT that both the Second[18] and Ninth[19] Circuits have adopted the conditions of participation versus conditions of payment concept is unsupported. *Mikes* raised the question of whether a False Claims Act violation was asserted based on doctors' failure to calibrate pulmonary testing after each use as recommended by the manufacturer. There was no mention whatsoever of calibration of pulmonary equipment in either the Medicare statute or the regulations! *Hopper* asserted a False Claims Act violation based on violation of a *state* law requiring the presence of the class room teacher during the evaluation of every student classified as needing special education. The courts in *Mikes* and *Hopper* refused to imply conditions not clearly set forth by Congress. The recruiter compensation ban, by contrast, is not implied but is plainly set forth in the statute.

Even assuming that Constitutional Power were not implicated by the ITT decision, nothing in the law of contracts permits a party in breach to escape liability because the agreement fails to explicitly identify the obligations which are "conditions of payment" versus other obligations undertaken. Equally infirm under the law of contracts is the rationale that the statutory language promises on *future* compliance, and therefore is not actionable.[20] Thirdly, the holding that the

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[18] *Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001).

[19] *United States ex rel. Hopper v. Anton*, 91 F.3d 1261, 1265 (9th Cir. 1996).

[20] The district court rule that "ITT agreed to comply in the future with the statutes and regulations governing the student financial assistance programs. However, the PPA did not require ITT to certify compliance with the incentive compensation

PPA — a contract required by statute — does not constitute the type of "obligation" needed to support a cause of action for a reverse false claim under § 3729(a)(7), directly conflicts with Sixth,[21] Seventh,[22] and Eighth[23] Circuits on this issue.

IV. The Court's guidance is needed now, or it the alternative, the Court should defer decision on this petition until the other circuits have ruled

The recruiter compensation ban is presently active in three (3) circuits. The Government is spending considerable resources to prevent the Fifth Circuit decision in the ITT case from being applied in other circuits. The Solicitor General filed an amicus brief in the U.S. Court of Appeals for the Ninth Circuit on January 10, 2005 in a case involving the identical issue of whether violation of the recruiter compensation ban by a proprietary school is actionable under the False Claims Act in No. 04-16247, entitled *United States of America ex rel. Julie Albertson and Mary Hendow v. University of Phoenix*. The Government argued that the Fifth

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prohibition." App. 32

[21] *American extile Manufacturers Institute, Inc. v. The Limited, Inc.*, 190 F.3d 729 (6th Cir. 1999).

[22] *United States ex rel. Lamers v. City of Green Bay*, 998 F. Supp. 971 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999).

[23] *United States v. Q International Courier, Inc.*, 131 F.3d 770 (8th Cir. 1997).

Circuit decision is incorrect.[24] In addition, the U.S. Department of Justice appeared for oral argument on January 14, 2005 in *United States of America ex rel. Jeffrey E. Main v. Oakland City University*, Civil No. 03-CV-71 in the U.S. District Court for the Southern District of Indiana, and again argued that Fifth Circuit decision in *ITT* is incorrect in response to defendant's motion to dismiss the False Claims Act suit brought against another proprietary school on the basis of its violations of the recruiter compensation provision in the Higher Education.

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[24] "By assuming that DOE lacked authority to withhold payment of Title IV funds based upon non-compliance with the incentive compensation ban, the district court is this case committed the same error as the district court in *United States ex rel. Graves v. ITT Educ. Servs., Inc.*, 284 F. Supp. 2d 487 (S.D. Tex. 2003), *aff'd mem.*, 111 Fed. Appx. 296 (5th Cir. 2004), where the court simply asserted that 'the regulation does not expressly condition the delivery of disbursement of funds to ITT students on ITT's certification of compliance with this requirement." *Id.* at 501. The decision in *Graves* is thus wrong not only because it rests on a misguided distinction between conditions of payment and conditions of participation for purposes of FCA liability, but also rests on an erroneous understanding of DOE's legal authority to withhold Title IV funds in this context." P. 29, fn. 4, amicus brief in *University of Phoenix*.

CONCLUSION

For those reasons and those set forth above, the petition for writ of certiorari should be granted and the judgments below reversed.

Respectfully submitted,

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Counsel for Petitioners

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 03-20460
[Filed Nov 18, 2004]

UNITED STATES OF AMERICA, ex rel.	)
DAN GRAVES; SUSAN NEWMAN	)
Plaintiffs-Appellants	)
	)
v.	)
	)
ITT EDUCATIONAL SERVICES, INC;	)
PRICE WATERHOUSE, COOPERS LLP;	)
RENE R. CHAMPAGNE	)
Defendant - Appellees	)
	)

Appeals from the United States District Court for the Southern District of Texas, Houston

ON PETITION FOR REHEARING EN BANC

(Opinion 10/20/04, 5 Cir., _____, _____ F.3d _____)

Before DeMOSS, DENNIS, and CLEMENT, Circuit Judges.

PER CURIAM:

(X) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition For Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

( ) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. The court having been polled at the request of one of the members of the court and a majority of judges who are in regular active service not having voted in favor (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

_____// S //_____
JAMES DENNIS
UNITED STATES CIRCUIT JUDGE

CLERK'S NOTE:

SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 03-20460
[Filed October 20, 2004]

UNITED STATES OF AMERICA, ex rel. Dan GRAVES and Susan Newman Plaintiffs-Appellants	)
v.	)
ITT EDUCATIONAL SERVICES, INC., PRICE WATERHOUSE, COOPERS LLP, and Rene R. Champagne, Defendant-Appellees	)

Appeals from the United States District Court for the Southern District of Texas

Civ. A. H-99-3889

Before DeMOSS, DENNIS, and CLEMENT, Circuit Judges.

PER CURIAM:*

In this False Claims Act case Relators Dan Graves and Susan Newman sued ITT Educational Services, Inc. and its Chairman Rene R. Champagne (together "ITT") along with its auditor Pricewaterhouse Coopers, LLP, alleging violations of the False Claims Act, 31 U.S.C. §3729, *et seq.* ITT participated in federal student financial aid programs under Title IV of the Higher Education Act of 1995, 20 U.S.C. §1078, *et seq.* Under these programs the United States Government insured educational loans and made direct educational grants to students enrolled at ITT. Title IV, Part G, §487(a)(20) of the HEA prohibits participating educational institutions such as ITT from making commission or incentive payments to admissions or recruitment personnel based on success in securing enrollments or financial aid to students. Relators contend that ITT and Champagne falsely promised to comply with the statute and falsely certified that ITT would comply with it. Relators also allege that Pricewaterhouse Cooopers, in its audits of ITT, made false statements as to ITT's attestations of compliance and as to whether ITT's financial statements fairly represented its financial condition.

ITT moved to dismiss Relators' complaint under Rule 12(b)(b) and Pricewaterhouse Coopers moved to dismiss under Rules 12(b)(6) and 9(b). Based on the factual allegations in Relators' complaint and the facts presented in Relators' exhibits, the district court granted Defendants' motions to dismiss with prejudice. Having reviewed the record and fully considered the parties' briefs and oral

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* Pursuant to 5TH CIR. R. 47.5, the Court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

arguments, we find no reversible error in the district court's judgment. We therefore AFFIRM the district court's judgment, *United States ex rel. Graves v. ITT Educational Services, Inc.*, 284 F. Supp. 2d 487 (S.D. Tex. 2003), essentially for the reasons stated in its memorandum opinion and order.[1]

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[1] For clarification purposes, we note shortly after the district court issued its opinion, a panel of this Court in *U.S. ex rel. Willard v. Humana Health Plan*, 336 F.3d 375 (5th Cir. 2003), stated: "While this Circuit has decided cases dealing with FCA liability based on express certifications of compliance with various statutes and regulations, we have not specifically addressed whether FCA liability can be based on an 'implied certification' theory." *Id.* at 381. Therefore, we must excise from an essential approval of the district court's reasons its statement that we have adopted an implied certification theory. 284 F.Supp. 2d 497. Notwithstanding this statement, the district court reached the correct result.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 04-20384
[Filed Nov 30, 2004]

United States of America, ex rel,	)
JAMES BOWAN,	)
Plaintiff-Appellant,	)
	)
v.	)
	)
EDUCATION AMERICA, INC.;	)
JERALD M. BARNETT, JR.;	)
PEDRO DEGUZMAN,	)
ERIN J. HINKLE;	)
KARON J. ROSA;	)
BOB SEELEY; SUZETTE GOODMAN,	)
Defendants-Appellees.	)
	)

Appeal from the United States District Court for the Southern District of Texas

(USDC No. 4:00-CV-3028)

Before REAVLEY, BARKSDALE and GARZA, Circuit Judges.

PER CURIAM:**

The district court ruled correctly in its memorandum and order of January 7, 2004. False certifications of compliance with applicable regulations and statutes governing participation in federal student financial aid programs under Title IV of the Higher Education Act did not constitute a basis for imposing liability on the defendants under the False Claims Act because the relator did not allege that the defendants made certifications of compliance with particular regulations on which payment was conditioned. *U.S. ex rel Graves v. ITT Educational Services, Inc.*, 284 F. Supp.2d 487 (S.D. Tex. 2003). AFFIRMED.

**Pursuant to 5TH CIR. R. 47.5, the Court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-99-3889
[Filed March 31, 2003]

UNITED STATES OF AMERICA EX REL. DAN GRAVES and SUSAN NEWMAN, Plaintiffs,	)
v.	)
ITT EDUCATIONAL SERVICES, INC., PRICEWATERHOUSE COOPERS, LLP and RENE CHAMPAGNE, Defendants	)

MEMORANDUM AND ORDER

This is a False Claims Act case. Relators, Dan Graves and Susan Newman, sued ITT Educational Services, Inc., which owns and operates approximately seventy technical colleges around the country; its chairman, Rene R. Champagne (together, "ITT"); and its outside auditor, Pricewaterhouse Coopers LLP ("PwC"). ITT participated in federal student financial aid programs under Title IV of the Higher Education Act of 1965, ("Title IV, HEA"), 20 U.S.C. § 1078, et seq. Under these programs, the United States Government insured educational loans and made direct educational grants to students enrolled at ITT. Title IV, part G, § 487(a)(20) of the HEA prohibits participating educational institutions such as

ITT from making commission or incentive payments to admissions or recruitment personnel based on success in securing enrollments or financial aid to students. Relators allege that ITT and Champagne falsely promised that ITT would comply and certified that ITT had complied with this regulation. Relators also allege that in its audits of ITT, PwC made false statements as to ITT's attestations of compliance and as to whether ITT's financial statements fairly represented its financial condition.

This court dismissed Relators' first amended complaint, finding that it failed to state a claim under the False Claims Act, ("FCA"), 31 U.S.C. § 3729, et seq., but allowing leave to amend. (Docket Entry No. 64). Relators filed a second amended complaint. (Docket Entry No. 65). Both ITT and PwC have moved to dismiss under Rule 12(b)(6), for failure to state a claim on which relief can be granted. PwC has also moved to dismiss under Rule 9(b), for failure to allege fraud with particularity. (Docket Entry Nos. 73, 74). Relators have responded. (Docket Entry Nos. 82, 83).

Based on the pleadings, the motions and responses, the parties' submissions, and the applicable law, this court GRANTS the motion to dismiss filed by ITT and Champagne, with prejudice, and GRANTS the motion to dismiss filed by PwC, with prejudice. The reasons for these rulings are explained below.

I. Background

ITT is a publicly traded corporation that owns sixty-eight post-secondary technical schools in the United States. (Docket Entry No. 65, P 13). Rene R. Champagne is the chairman, president, chief executive officer, and a director of ITT. (*Id.* at P 6). Relators Dan Graves and Susan Newman were

admissions/recruitment representatives at the Santa Clara, California ITT campus. Newman began working in 1998; Graves in 1999. Both were employed until February 2000. (*Id.* at PP 2-3).

ITT employed two categories of admissions/recruitment representatives. ITT had approximately two hundred and fifty-five "inside" representatives who worked in student recruitment offices located on ITT campuses. ITT also had approximately two hundred and fifty-five "outside" representatives who visited high school seniors and other prospective students. (*Id.* at P 58). Relators allege that from 1993 to the present, all of ITT's campuses paid its admissions/recruitment representatives under an "incentive salary structure" providing for the payment of "5% of earned revenues for Inside Representatives and 10% of earned revenues for Outside Representatives." (*Id.* at P 56). Relators allege that because the "level of 'earned revenue' was a direct function of the new and continuing students and graduates who are enrolled by the admissions and recruitment representative," the salary program was "an incentive salary structure that violated federal statute." (*Id.*). Defendants assert that they paid salaries to admissions and recruitment personnel that complied with the regulatory requirement of avoiding bonuses based on the number of students enrolled or the amount of financial aid obtained. This court does not, of course, address this dispute in this motion to dismiss.

Relators allege that ITT made "claims for payment" to the federal government through its participation in programs that enabled it to receive Title IV, HEA funds. These funds included federally guaranteed student loan funds administered under the Federal Family Education Loan Program ("FFELP"), the Federal Pell Grant Program, and the Federal Direct Student Loan Program. Under the FFELP, banks make

loans to eligible borrowers, who are students enrolled at post-secondary schools approved to participate in Title IV, HEA programs. The student applies and the school certifies the student's eligibility. The application is submitted to the lender, which is usually a bank, and to a guaranty agency, which is usually a state agency or nonprofit organization. The funds are issued to the student and school jointly and the school disburses the funds to the student to use for tuition payments. If a student defaults in repayment, the guaranty agency reimburses the lender. If the agency is unable to collect, the Department of Education reimburses the guaranty agency.

The Pell Grants are direct grants of student financial aid. A student at a participating school applies for a Pell Grant. If the school finds that the student meets the eligibility requirements, it approves the application. The school asks the Department of Education for funds to pay the grant to the student. The request is made electronically to a federal Pell Grant Account maintained at the school. The Department of Education makes electronic fund transfers to a designated account for the school, which must hold the funds in trust for the Department and the designated student beneficiary until disbursed, which much be accomplished in three days.

Relators allege that from 1993 to 1999, ITT submitted applications for, and accepted, financial aid for students enrolled on its campuses under both the FFELP and the Pell Grant Program. Relators do not allege that the applications themselves were false, in that they contained false information as to the students' eligibility or the purpose for the funds. Nor do Relators contend that the funds were not disbursed to the students to be used as stated or that educational services were not provided as represented. Rather, Relators contend that because ITT received student financial aid funds while ITT

was "in violation of the incentive compensation prohibition" of Title IV, § 487, ITT "knowingly presented, or caused to be presented, false or fraudulent claims for payment or approval," in violation of 31 U.S.C. §§ 3729(a)(1), (a)(2), and (a)(7). As to PwC, Relators contend that it failed properly to perform its outside auditor functions in the compliance examination of ITT and in the review of ITT's financial statements. Relators contend that PwC's compliance reports and reports on PwC's financial statements were false statements issued in support of ITT's improper receipt of government funds.

This court dismissed the first amended complaint, identifying a number of pleading deficiencies. This court found that the Relators did not detail how or when ITT made claims upon the government. This court also found that Relators did not plead facts that, if proven, would show that ITT and PwC made false statements or certifications. The second amended complaint adds considerable detail to the allegations as to how Title IV, HEA funds are disbursed through post-secondary schools to students under both guaranteed loan programs and direct grants. Relators argue that the second amended complaint alleges sufficient facts that, if proven, would show that ITT falsely certified its compliance with the prohibition against incentive compensation paid to recruiters and admissions personnel and fraudulently induced the government to pay funds under the Title IV, HEA programs by promising to comply with this regulation. Relators allege that by receiving student financial aid funds knowing it had failed to comply with the Title IV, § 487 requirement prohibiting incentive compensation payments to admissions officers or recruiters based on the number of students enrolled or the amount of amount of student financial assistance obtained, ITT made false claims for government payment. Relators also allege that PwC made

false statements or certifications that were used in connection with the submission of ITT's false claims to the government.

The second amended complaint alleges the following as the false statements or certifications:

- The Program Participation Agreements (PPA) that ITT executed for each of its campuses contained statements by ITT promising future compliance with Title IV, HEA Program regulations and the terms of the PPA. The regulations included the incentive compensation prohibition.

- As part of the annual compliance audit, ITT managers executed management assertion letters to PwC. These letters confirmed to PwC that the school had, in the reporting period, complied with the requirements of Title IV, which included the incentive compensation prohibition

- PwC issued an opinion letter as outside auditor for ITT, reporting on ITT's compliance with Title IV, HEA Program requirement, that failed to disclose the violation of the incentive compensation prohibition.

- PwC issued unqualified opinions on ITT's financial statements as part of the audits, which were false representations that PwC had audited ITT's financial statements in accordance with GAAS and that the financial statements were fairly presented in accordance with GAAP. Relators contend that the audit opinions should have included a qualified or adverse opinion on the financial statements as a result of ITT's failure to

meet the Title IV eligibility requirement of avoiding incentive compensation, which threatened ITT's viability.

- Relators also alleged, upon information and belief, a fifth statement by ITT, falsely certifying ITT's compliance with Title IV requirements, contained in Agency Forms 272 that ITT submitted to the government.[1]

(Docket Entry No. 65).

Relators referred to, but did not attach, a copy of a PPA to the first amended complaint. ITT submitted a standard form PPA. (Docket Entry No. 43, Ex. 2). Similarly, Relators did not quote or submit a copy of a ITT Management Attestation Letter to PwC, a copy of a Compliance Audit Report Opinion from PwC to the ITT board of directors, or a copy of a financial audit report opinion from PwC to ITT's board of directors. ITT and PwC have attached these documents to their submissions. (Docket Entry No. 73, Ex. A-E). Relators have not challenged the contents of any of these documents.[2]

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[1] Relators did not quote, attach, or describe the contents of the Agency Form 272. The allegations as to this form are insufficient to provide a basis for a cause of action under the FCA.

[2] Relators objected to defendants' requests to take judicial notice of the ITT and PwC documents that are referred to in the second amended complaint, including the ITT management attestation reports, the PwC audit reports on ITT's financial statements, and the PwC compliance report. (Docket Entry Nos. 85, 100). Relators argued that the documents were incomplete and in particular argued that PwC must also include its internal control reports for the company. PwC, while denying that this step is

Relators allege that ITT and PwC violated section 3729(a)(1) of the FCA, by knowingly presenting a false claim for payments from the United States government; section 3729(a)(2), by knowingly making a false statement to get a false or fraudulent claim paid or approved by the government; section 3729(a)(3), by conspiring to present false claims to the government; and section 3729(a)(7), by making or using a false statement to conceal or decrease an obligation to pay money to the government. Relators also allege that ITT terminated Susan Newman's employment in retaliation for reporting ITT's violations to the United States, in violation of section 3730(h), the antiretaliation provision of the FCA. Relators seek a judgment in the amount of three times the damages the United States sustained, a civil penalty of $ 5,000 to $ 10,000 for each violation, reasonable attorney fees, costs, and prejudgment interest. (Id. at P 113). Because the United States has decided against intervention, Relators seek an

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necessary on completeness grounds, supplied the internal control reports. (Docket Entry No. 103, Ex. A-E). The objection is denied.

Relators further objected to the request to take judicial notice of ITT's management representation letters. (Docket Entry No. 99). Relators argue that judicial notice is improper because "relators are entitled to know of all management assertions ITT has made." (Docket Entry No. 99, p. 2). Relators have not explained how the absence of other documents makes the documents presented misleading. This court takes judicial notice of the documents referred to in Relators' second amended complaint that are central to their claims. *Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498-99 (5th Cir. 2000). The objections to judicial notice as to the ITT documents are overruled.

award of between twenty-five and thirty percent of the proceeds. (Id.).[3]

Defendants have moved to dismiss the claims against them. In the motions to dismiss the second amended complaint, ITT and PwC both assert that Relators have still failed to allege facts that, if proven, would show a basis for False Claims Act liability. PwC has moved to dismiss on the basis of both Rule 12(b)(6) and Rule 9(b); ITT moves only under Rule 12(b)(6). The motions, arguments, and responses are addressed in detail below.

II. The Applicable Legal Standards

A. The Rule 12(b)(6) Standard

A claim may not be dismissed under Rule 12(b)(6) "unless it appears certain that the plaintiff cannot prove any set of facts in support of her claim which would entitle her to relief." *Hishon v. King & Spalding*, 467 U.S. 69, 73, 81 L. Ed. 2d 59, 104 S. Ct. 2229 (1984); *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957); *Piotrowski v. City of Houston*, 51 F.3d 512, 514 (5th Cir. 1995). In deciding a Rule 12(b)(6) motion, the factual allegations of the complaint must be accepted as true, *see Cruz*

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[3] Relators filed suit under seal, under the FCA procedures, and notified the United States. On May 25, 2001, after the suit had been on file for almost two years, the government filed notice of its election to decline intervention. (Docket Entry No. 35). The government asked that only certain parts of the file be unsealed. On May 31, 2001, this court entered an order unsealing the complaint, to be served on the defendants, and keeping other parts of the file under seal. (Docket Entry No. 37).

v. Beto, 405 U.S. 319, 322, 31 L. Ed. 2d 263, 92 S. Ct. 1079 (1972), and the complaint construed favorably to the pleader. *See Underwood v. Archer Mgmt. Servs., Inc.*, 857 F. Supp. 96, 97 (D.D.C. 1994).

The court may consider the facts presented in exhibits to the complaint, as well as the factual allegations of the complaint itself. *See Zinermon v. Burch*, 494 U.S. 113, 118, 108 L. Ed. 2d 100, 110 S. Ct. 975 (1990); *Caine v. Hardy*, 943 F.2d 1406, 1411 n.5 (5th Cir. 1991); *see also* FED. R. CIV. PROC. 10(c)("A copy of any written instrument which is an exhibit to a pleading is a part thereof for all purposes."). "The court will not accept as true allegations that are contradicted ... by other allegations or by exhibits attached to or incorporated in the pleading." 5A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1363. The Seventh Circuit has held that

> [a] plaintiff is under no obligation to attach to her complaint documents upon which her action is based, but a defendant may introduce certain pertinent documents if the plaintiff failed to do so. Documents that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim.

Venture Assoc. Corp. v. Zenith Data Systems Corp., 987 F.2d 429, 431 (7th Cir. 1993); *see also Sheppard v. Texas Dep't of Transp.*, 158 F.R.D. 592, 597 (E.D. Tex. 1994) ("[A] court may rely upon a defendant's exhibit when it is referred to in the plaintiff's complaint and is central to plaintiff's claim"); 5 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1327 (2D ed. 1990) ("When plaintiff fails to introduce a pertinent document

as part of his pleading, defendant may introduce the exhibit as part of his motion attacking the pleading."). In this case, this court may consider the copies of the documents that Relators referred to in the second amended complaint and alleged contained the false statements made the basis of the FCA causes of action, that defendants attached to their motions to dismiss. Relators referred to the Program Participation Agreements, ITT's management attestation reports; PwC's compliance audit reports; PwC's audit opinion letters; and a portion of ITT's Form 10-K in the first amended complaint, and those documents are central to Relators' claims.

Although this court must accept as true "well-pleaded" factual allegations in the complaint, the court need not accept as true "conclusory" allegations or allegations of inferences that are contradicted by the facts pleaded or set out in the exhibits attached to or incorporated in the pleading. *See, e.g., Blackburn v. City of Marshall*, 42 F.3d 925, 931 (5th Cir. 1995) ('"conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to prevent a motion to dismiss'") (quoting *Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 284 (5th Cir. 1993)).

B. The Rule 9(b) Standard

Federal Rule of Civil Procedure 9(b) provides that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Id. "Although the particularity demanded by Rule 9(b) differs with the facts of each case, a plaintiff pleading fraud must set forth 'the who, what, when, and where ... before access to the discovery process is granted.' Anything less fails to provide defendants with adequate notice of the nature and grounds of the claim." *Hart*

v. Bayer Corp., 199 F.3d 239, 248 n.6 (5th Cir. 2000). Rule 9(b) has four purposes: to ensure that the defendant has sufficient information to formulate a defense by having notice of the conduct complained of; to protect defendants against frivolous suits; to eliminate fraud actions in which all the facts are learned after discovery; and to protect defendants from undeserved harm to their goodwill and reputation. *See United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 783 (4th Cir. 1999). Rule 9(b) must be interpreted and applied in light of these purposes. The Fifth Circuit has specifically held that "the complaint in a False Claims Act suit must fulfill the requirements of Rule 9(b)." *United States ex rel. Russell v. Epic Healthcare Management Group*, 193 F.3d 304, 308 (5th Cir. 1999) (citing *United States ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 125 F.3d 899, 903 (5th Cir. 1997)).

II. The False Claims Act Claims in the Second Amended Complaint

A. The Statutory Framework

The purpose of the False Claims Act is "to provide for restitution to the government of money taken from it by fraud." *United States v. Hess*, 317 U.S. 537, 551, 63 S. Ct. 379, 87 L. Ed. 443 (1943). Liability under the False Claims Act occurs when a person or entity:

> (1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;
>
> (2) knowingly makes, uses, or causes to be made or

> used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;
>
> (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid; or
>
> (7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.

31 U.S.C. § 3729(a).

The term "knowingly" has a special meaning within the context of the False Claims Act:

> "knowing" and "knowingly" mean that a person, with respect to information–
>
> (1) has actual knowledge of the information;
>
> (2) facts in deliberate ignorance of the truth or falsity of the information; or
>
> (3) acts in reckless disregard of the truth or falsity of the information, and no proof of specific intent to defraud is required.

31 U.S.C. § 3729(b). The FCA does not, however, define "false or fraudulent."

Defendants assert that the second amended complaint fails to allege a "claim" that was "false or fraudulent" or that was made with a "false statement." Defendants recognize that false

certifications of compliance with a prerequisite to government payment may provide the "false statement" or "false claim" for the purpose of the False Claims Act. Defendants contend that Relators have not alleged facts necessary to state a cause of action under theories of either false certification or fraud in the inducement.

B. The Requirement of a "Claim"

The Supreme Court has cautioned that the False Claims Act was not designed to punish every type of fraud committed upon the government. *See United States v. McNinch,* 356 U.S. 595, 599, 2 L. Ed. 2d 1001, 78 S. Ct. 950 (1958). "The statute attaches liability, not to the underlying fraudulent activity or to the government's wrongful payment, but to the 'claim for payment.'" *United States v. Rivera*, 55 F.3d 703, 709 (1st Cir. 1995). A central question in False Claims Act cases is whether the defendant presented a "false or fraudulent claim" to the government.

The False Claims Act states that a claim "includes any request or demand ... for money or property" where the government provides any portion of the money or property to the "contractor, grantee, or other recipient" or if the government will "reimburse such contractor, grantee or other recipient" for any portion of the money or property. 31 U.S.C.A. § 3729(c). The False Claims Act requires the presence of a claim--"a call upon the government fisc"--for liability to attach. *Harrison*, 176 F.3d at 785 (citing *United States v. McNinch,* 356 U.S. 595, 599, 2 L. Ed. 2d 1001, 78 S. Ct. 950 (1958)). In *United States ex rel. Hopper v. Anton*, the court explained that:

> It is not the case that any breach of contract, or violation of regulations, or receipt of money from the

> government where one is not entitled to receive the money, automatically gives rise to a claim under the FCA ... The FCA is far narrower. It requires a false claim. Thus, some request for payment containing falsities made with scienter (i.e., with knowledge of the falsity and with intent to deceive) must exist.

91 F.3d 1261, 1265 (9th Cir. 1996).

Relators have alleged two categories of payments in this case, guaranteed loans and direct student grants. Under the FFELP, a participating institution that has entered into a PPA, such as ITT, and an eligible student submit an application to a private lender for a loan on behalf of that student. The lender — typically a bank — issues a check for tuition, made payable to both the student and the institution, for the student to use to pay tuition. The Department of Education subsidizes interest payments on the loans during the period that the student is actively enrolled in classes and during certain grace periods. The loans are guaranteed by state agencies or nonprofit organizations and subsidized and reinsured by the Department of Education. If the student fails to repay the loans, the guaranteeing agency reimburses the lender for the balance and attempts to collect the unpaid amount. If the agency is unsuccessful, the Department reimburses the guaranteeing agency for the loss or accepts assignment of the loan. 20 U.S.C. § 1078(c)(1)(A); 34 C.F.R. §§ 682.400(b)(3), 682.404, 682.409(a)(1).

The cases recognize that when there is a government-insured loan, a claim under the False Claims Act only occurs when the borrower defaults and the government must make payment. *United States v. Rivera*, 55 F.3d 703, 710 (1st Cir. 1995); *United States v. Vanoosterhout*, 898 F. Supp. 25, 29 (D.D.C. 1995). Under the FFELP, the government does not

provide the loan to the student or to ITT; those funds are paid by the private lender. If there is a default, the guaranteeing agency reimburses the lender. If the agency is unable to collect, the government then reimburses the agency that guaranteed the loan. ITT does not receive government funds when the loan is made and if a default occurs, the government does not receive a demand for payment from ITT.

The Department calculates a "cohort default rate" on a school-by-school basis. Relator alleges that each year, the government incurs significant losses because of student defaults on government-insured loans, including defaults by students who borrowed money for tuition payments to ITT. However, the description of the operation of the federally guaranteed loan program does not identify a claim made by ITT for payment from the government, as necessary for a "claim" under the False Claims Act.

Relators also allege that ITT received funds through the federal Pell Grant Program. Only institutions that enter into a PPA may receive Pell Grant funds to disburse to its eligible students. The participating school requests funds from the Department to pay for grants for eligible students. Those funds are deposited in an institutional account, to be held in trust for the intended student beneficiaries and the Department. 34 C.F.R. § 668.161(b). The students, not the school, prepares an application for a Pell Grant, which the student may submit directly to the Department of Education or give to the school to transmit to the Department of Education. If the individual student applications are the "claims," they appear to be the claim of the student, rather than of the school. The only funds the school receives must be disbursed to the students within a few days. 34 C.F.R. § 668.162(b). ITT and PwC argue that nothing in this regulatory process identifies a "claim" that ITT submits to the government for payment.

Courts have held, without discussion, that applications for Pell Grants are "claims" that can provide a basis for False Claims Act liability both as to the student receiving the funds and to the school. *See, e.g., United States v. St. Augustine College*, 1991 U.S. Dist. LEXIS 15097, 1991 WL 222099 (N.D. Ill. Oct. 21, 1991) (college violated False Claims Act by disbursing Pell Grant funds to ineligible students); *United States v. Watkins*, 2002 U.S. Dist. LEXIS 10029, 2002 WL 1263988 (N.D. Ill. June 5, 2002) (Pell Grant applicants submitted false information as to eligibility).

Relators have not alleged that the individual applications or requests for funds were false or contained false statements. The thrust of Relators' suit is that ITT and PwC falsely certified ITT's compliance with one of the requirements for participation in the Title IV, HEA program. Relators allege both a false certification and a fraud in the inducement basis for False Claims Act liability. Under these theories, misrepresentations of compliance with a regulation governing participation in a government contract is held to "taint" all claims submitted under that contract.

C. The Theory of False Certification

The "false certification theory" of False Claims Act liability is predicated on a false certification of compliance with a federal statute, regulation, or contractual term that is a prerequisite to obtaining a government benefit. A theory of "legally false" certification differs from "factually false" certification, which involves an incorrect description of goods or services provided or a request for reimbursement for goods or services never provided. *See Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001).

The Fifth Circuit, with the Second, Fourth, Ninth, and District of Columbia Circuits, has held that a claim under the False Claims Act is "legally false" only where a party affirmatively certifies compliance with a statute or regulation as a condition to receiving governmental payment or property. *See United States ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 125 F.3d 899 (5th Cir. 1997); *United States ex rel. Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001); *United States ex rel. Hopper v. Anton*, 91 F.3d 1261 (9th Cir. 1996); *United States ex rel. Siewick v. Jamieson Science and Engineering, Inc.*, 341 U.S. App. D.C. 459, 214 F.3d 1372 (D.C. Cir. 2000); *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776 (4th Cir. 1999). The Fifth Circuit has emphasized that liability for a false certification will lie only if compliance with the regulation was a prerequisite to government payment, and the defendant affirmatively certified such compliance. The violation of the statute or regulation does not create a cause of action under the False Claims Act; liability arises only if the defendant has made a false certification of compliance with the statute or regulation, when payment is conditioned on that certification.[4]

The Fifth Circuit, in *United States ex rel. Thompson v. Columbia HCA Healthcare Corp.*, adopted an implied certification theory, but with limits. The Fifth Circuit emphasized that receiving government funds while in violation of a statute or regulation applicable to the funding program

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[4] The requirement of a false certification of compliance with a regulation that is a condition to payment is separate from, although related to, the requirement of materiality. "A materiality requirement holds that only a subset of admittedly false claims is subject to False Claims Act liability." *Mikes v. Straus*, 274 F.3d 687, 697 (2d Cir. 2001).

constitute false claims under the False Claims Act. "Where the government has conditioned payment of a claim upon a claimant's certification of compliance with, for example, a statute or regulation, a claimant submits a false or fraudulent claim when he or she falsely certifies compliance with that statute or regulation." 125 F.3d at 902.

In *Thompson,* the relator alleged that under Medicare, the defendant health care providers had to certify in annual cost reports that the services they had provided over the prior year met the regulations for healthcare services. The specific regulations and statutes precluded payment for referrals of Medicare patients and prohibited physicians from referring Medicare patients to entities that had certain financial relationships with the referring doctor. Certain of the regulations and statutes expressly prohibited submitting claims or receiving payment for services rendered in violation of the provisions. Defendant argued that its general statement of compliance with the laws and regulations governing the provision of healthcare services contained in the annual cost reports was not a prerequisite to receiving payment for those services. Defendant emphasized that it submitted claims for reimbursement and received payment shortly after the services had been rendered. The government reviewed and paid the claims long before the government received the annual cost reports. The relator responded that the annual cost reports with the certifications of compliance were nonetheless prerequisites to payment because "the retention of any payment received prior to the submission of an annual cost report is conditioned on the certification of compliance contained therein." *Id.* at 902-903. Because the record was unclear on that point, the Fifth Circuit denied defendants' Rule 12(b)(6) motions and remanded for further factual development. *Id.*

On remand, the district court found that the certifications of compliance in the annual cost reports stated claim under the False Claims Act. The certifications were a condition of retention of payments made during the prior year, as well as a condition of continued eligibility for participation in the Medicare program. *Thompson v. Columbia/HCA Healthcare Corp.*, 20 F. Supp.2d 1017, 1034, 1041-42, 1046 (S.D. Tex. 1998). Under the applicable regulations, the government made interim payments during the year for services rendered, but those payments were conditional. The right to retain the payments was not determined until the hospital's annual cost report was submitted, reviewed, and approved. Under the regulations, if the provider failed to make the certification and cost report, all the interim payments made during the year covered by the report could be deemed overpayments. Under these circumstances, the district court concluded that certification of compliance was a prerequisite to retaining the funds previously advanced on an interim basis. *Id.*

Since *Thompson*, the Fifth Circuit has reiterated that "when the government has conditioned payment of a claim upon a claimant's certification of compliance with a provision of a contract entered into pursuant to a regulation, a claimant submits a false claim as a matter of law when he or she falsely certifies compliance with that provision." *United States v. Southland Management Corp.*, 288 F.3d 665, 679 (5th Cir. 2002), *reh'g en banc granted*, 307 F.3d 352 (5th Cir. 2002). In that case, the court emphasized the two elements necessary to state a claim under a false certification theory of False Claims Act liability: the defendant makes a knowingly false certification of compliance with a statute or regulation and that certification is a prerequisite to payment.

In *United States ex rel. Mikes v. Straus*, another Medicare case, the Second Circuit limited implied false certification as

a basis for liability to circumstances in which the underlying statute or regulation on which the relator relied expressly stated that the defendant must comply in order to be paid. The court held that the certification of compliance must be a precondition to payment before False Claims liability could attach, to avoid improperly broadening the Act's reach. 274 F.3d at 699-700.

In *United States ex rel. Siewick v. Jamieson Science and Engineering, Inc.*, the D.C. Circuit adopted a similar position, noting that "all courts of appeals to have addressed the matter" hold that a "false certification of compliance with a statute or regulation cannot serve as the basis for a qui tam action under the FCA unless payment is conditioned on that certification." 214 F.3d at 1376.[5] In *United States ex rel. Hopper v. Anton*, a teacher accused her school district of making a false claim for special education funds while failing to comply with state and federal laws governing special education services. The Ninth Circuit held that she could not maintain an action under the False Claims Act. The court held that the school district did not make a false claim when it certified that it "'will meet ... all requirements of state and federal law.'" 91 F.3d at 1267. The school's certification was not a false certification of a present fact and there was no allegation that the school district's certification was the basis for the improper payment. *Id.*

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[5] In *U.S. ex rel. Augustine v. Century Health Services, Inc.*, 289 F.3d 409, 415 (6th Cir. 2002), the court held that Medicare cost reports submitted by defendant with a certification that it complied with all applicable instructions certified compliance with Medicare requirements and could give rise to False Claims Act liability "if the claimant violates its continuing duty to comply with the regulations on which payment is conditioned." (Emphasis added).

In *Shaw v. AAA Engineering & Drafting, Inc.*, 213 F.3d 519 (10th Cir. 2000), the Tenth Circuit adopted an implied certification theory. The defendant in AAA Engineering was being paid for both photography services and for following specified environmental practices in disposing of certain solutions. When the defendant submitted invoices for full payment, knowing it had failed to provide some of the required services for which it was being paid, the implied certification theory applied. In *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776 (4th Cir. 1999), the Fourth Circuit did not address the "validity and problems of an implied certification theory of liability," but noted that such claims are "questionable." *Id.* at 787.

This court applies the precedents on false certification claims to the second amended complaint.

D. Relators' Allegations as to ITT's False Certifications

Relators allege that ITT expressly falsely certified in the PPA its agreement to comply with the recruiter compensation provisions of the HEA. Each PPA states in bold print: "The execution of this agreement by the Institution and the Secretary is a prerequisite to the institution's initial or continued participation in any Title IV, HEA Program." (Docket Entry No. 43, Ex. 2). The PPA states that "provisional certification is granted for a limited period to permit the Institution to participate in Title IV, HEA Programs referenced in this Agreement." (*Id.* at p.2). During the provisional certification period, the institution's participation is "subject to revocation for cause," which includes "failure to comply with any provision set forth in this Agreement, a violation of Department regulations deemed material by the Department, or a material misrepresentation in the material submitted to the Department as part of the

Institution's application process for this certification." (*Id.*). The Agreement also states that "the Department in its sole discretion may provide the Institution with an opportunity to cure any such failure, may place the Institution on reimbursement funding pending a decision regarding revocation of this Agreement ... or may suspend the participation of the Institution pending a decision by the Department regarding revocation of this agreement." (*Id.*). The PPA provides that if the Department chooses to revoke the PPA, "the Institution will have the right to show cause why this Agreement should not be revoked ...." (*Id.*).

The General Terms and Conditions section of the PPA states that "the Institution understands and agrees that it is subject to and will comply with the program statutes and the implementing regulations for institutional eligibility as set forth in 34 CFR Part 600 and for each Title IV, HEA Program in which it participates, as well as the general provisions set forth in Part F and Part G of Title IV of the HEA ...." (*Id.* at p. 3). The General Terms and Conditions section also provides, in part, as follows:

> By entering into this Program Participation Agreement, the Institution agrees that:
>
> (1) It will comply with all statutory provisions of or applicable to Title IV of the HEA, all applicable regulatory provisions prescribed under that statutory authority ....
>
> ...
>
> (12) It will provide the certifications described in paragraph (c) of this section;

...

> (22) It will not provide, nor contract with any entity that provides, any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the awarding of student financial assistance ....[6]

(*Id.* at pp. 4-6).

Paragraph (c) states that in order to participate in any Title IV, HEA program, the institution must expressly certify: (1) that it has a drug abuse prevention program, and (2) that it has a campus security policy and has complied with disclosure requirements regarding campus security. (*Id.* at p. 6).

Another section, entitled "Certifications Required From Institutions," requires the institution to make the following express certifications:

- That no federal funds are being used for lobbying. (*Id.* at pp. 7-8).

- That the institution and its principals are not debarred by any federal department or agency and have not been convicted of a crime or had a fraud judgment entered against them within three years of the application. (*Id.* at p. 8).

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[6] This is a verbatim recitation of 20 U.S.C. § 1094(a)(20).

- That the institution is a drug-free workplace. (*Id.* at pp. 8-9).

- That the institution has implemented and adopted a drug prevention program for its students and employees. (*Id.* at p. 9).

Nothing in the PPA required ITT expressly to certify compliance with the provision prohibiting incentive payments. In the PPAs, ITT agreed to comply in the future with the statutes and regulations governing the student financial assistance programs. However, the PPA did not require ITT to certify compliance with the incentive compensation prohibition.

The management attestation letters ITT provided to PwC as part of the periodic compliance audit contain certifications of compliance with the numerous requirements of the student financial assistance programs over the previous period. Each management representation letter stated that ITT "confirms, to the best of our knowledge and belief," that ITT has "complied with all SFA compliance requirements detailed in Exhibit I of this letter." (Docket Entry No. 76, Ex. 2, P 2, p.l). Exhibit I lists a number of compliance requirements, including that the institution has not in the past period under review "paid to any persons or entities any commissions, bonus, or other incentive payment based directly or indirectly in securing enrollments, financial aid to students, or student retention." (*Id.*). The management attestation letters were not submitted to the government, but to PwC, which would subject the letters, with the payroll and related compensation records, to testing, as part of the compliance audits. However, PwC included the management attestation letters in the compliance audit documents that were provided to the Department of Education. The critical issue is whether the

management attestation letter certification of compliance with the statutory and regulatory provisions was a condition of payment.

The courts have addressed certifications in the form of an after-the-fact general statement that the entity receiving federal funds under a government program or contract has complied with all applicable statutes, laws, regulations, and contract terms. The courts have found no liability under the False Claims Act unless the certification is a prerequisite to payment. *Thompson*, 125 F.3d at 902-903. The statute or regulation at issue must expressly state that certification of compliance is a condition of payment. *Mikes*, 274 F.3d at 700. These courts identify the critical issue as whether the certification of compliance with a specific regulation or statute was a condition for payment. The courts in *Thompson* and *Mikes* recognized a distinction between generally certifying compliance with applicable regulations and statutes governing participation in a program, as opposed to certifying compliance with a particular requirement that is a prerequisite to receiving or retaining payment under that program. The *Thompson* decision emphasized that liability for false certification under the False Claims Act could arise only when the government has conditioned payment of a claim on the certification of compliance.

In *Mikes v. Straus*, the Second Circuit declined to follow a Court of Federal Claims opinion adopting a broader implied certification approach. 274 F.3d at 701-702. *In Ab-Tech Construction, Inc. v. United States*, 31 Fed. Cl. 429 (Fed. Cl. 1994), *aff'd*, 57 F.3d 1084 (Fed. Cir. 1995) (unpublished table decision), the Court of Claims held that the defendants' submission of payment vouchers implicitly certified their continued compliance with the eligibility requirements of a federal small business statutory program, exposing them to False Claims Act liability. The Second Circuit significantly

limited this approach, holding that the False Claims Act was not designed to enforce compliance with all regulations on participation in, or eligibility for, a particular government program, but only those regulations that expressly state that compliance is a precondition to payment or retention of payments. "Implied false certification is appropriately applied only when the underlying statute or regulation upon which the plaintiff relies expressly states the provider must comply in order to be paid." *Id.* at 700.

Since *Ab-Tech*, the Ninth Circuit, in *Hopper*, the Fifth Circuit, in *Thompson*, and the Second Circuit, in *Mikes*, have held that the appropriate inquiry is whether the defendants' certification of compliance with the regulation at issue was a condition to payment. A general statement of adherence to all regulations or statutes governing participation in a program through which federal funds are received is insufficient as a basis of False Claims Act liability.

These authorities, applied to the regulations and documents at issue here, show that the documents Relators allege as a basis for ITT's liability under the False Claims Act did not certify compliance as an express precondition to payment. The PPA acknowledges the application of a number of Title IV, HEA requirements, but does not certify compliance with the regulation governing incentive compensation. The management attestation letter is a general statement of compliance with applicable regulations and laws in a prior period under review. The regulations require that, among the conditions of initial and continued eligibility for the Title IV, HEA program, the institution may not make incentive compensation payments to its student recruiters or admissions personnel. However, the regulation does not expressly condition the delivery or disbursement of funds to ITT students on ITT's certification of compliance with this

requirement. 20 U.S.C. § 1094(20). In contrast, the regulations at issue in Thompson expressly prohibited the payment of government funds for services rendered in violation of the physician anti-referral statute. *Thompson*, 20 F. Supp. 2d at 1040.

ITT's management attestation letters generally certified compliance with a number of requirements for the prior period under review, long after funds received had been received disbursed. ITT points out that the management attestation letter cannot be a condition of payment of funds because the student financial aid funds were paid long before the management attestation letter issued. Relators assert that they have alleged that ITT's retention of such funds was conditioned on the certification of compliance with, among other requirements, the avoidance of incentive compensation paid to certain personnel. (Docket Entry No. 96, pp. 14-15). However, a review of the second amended complaint does not reveal such an allegation and the regulations do not appear to provide a basis to make it. Relators cite 34 C.F.R. § 668.22, but that provision discusses refunds if students become ineligible, not if the institution becomes ineligible. There are a number of administrative remedies available for noncompliance with regulations governing Title IV, HEA, but Relators have not identified a regulation conditioning payment or retention of financial aid funds on certification of compliance with the prohibition on incentive compensation.

The regulations state that if a school fails to meet the compliance audit requirements, of which the management attestation letter is but one part, or if it loses its eligibility, or if it violates or fails to carry out regulatory requirements, the Department of Education has a number of administrative and other remedies available. These include requiring additional audits; taking action to terminate the institution's eligibility

designation; taking action to limit the authority of the institution to disburse or deliver funds under Title IV, HEA programs; or imposing a civil penalty for a violation of, or failure to carry out, a regulatory requirement. 34 C.F.R. §§ 600.41 (a)(1), (a)(2); 20 U.S.C. § 1094(c)(3)(B)(i)(II); 20 U.S.C. § 1099(c)(5). However, Relators did not allege or provide authority showing that ITT's receipt of Title IV, HEA funds in any year was on an "interim" or "provisional" basis," like the Medicare funds paid in Thompson, subject to forfeiture if ITT failed to submit the certification of compliance with the incentive compensation prohibition.

In contrast to the regulations at issue in Thompson, the regulations at issue here do not expressly condition payment or retention of the student loans and grants paid on behalf of students under Title IV, HEA on the submission of certification of compliance with the regulation or statute at issue. Like one of the regulations at issue in *Mikes*, the regulation that Relators allege was violated is a condition of eligibility to participate in the program, not an express condition of payment of specific claims or retention of payments. *See Mikes*, 274 F.3d at 702 (holding that because the regulation allegedly violated was a condition of participation, which did not "expressly condition payment on compliance with its terms," the certification of compliance was not legally false) (emphasis in original). Under the authority Relators cite, the PPA does not certify compliance and ITT's management attestation letter does not certify compliance with a regulation that makes the certification a requirement of payment or retention of funds.

Relators have failed to allege that ITT made false certifications of compliance on which payment was conditioned, so as to support a false certification cause of action under the False Claims Act.

E. Relators' Fraud in the Inducement Claim

Relators assert that the second amended complaint states a cause of action against ITT for fraud in the inducement as a basis for liability under the False Claims Act. This court has described False Claims Act liability under the "fraud in the inducement" theory as follows:

> In such a case, False Claims Act liability is asserted as to each claim submitted to the government under a contract, if that contract was originally obtained through false statements or fraudulent conduct. The claims for payment may be accurate, but the antecedent fraud in obtaining the contract makes each claim submitted a false or fraudulent claim.

United States ex rel. Wilkins v. N. Am. Constr. Corp., 173 F. Supp. 2d 601, 621; *see also Harrison*, 176 F.3d at 787-88 & n.10 (describing history of fraud in the inducement claims in False Claims Act context).

However, this theory requires more than the allegation that a defendant has accepted federal funds while in violation of certain funding program requirements. *Hopper*, 91 F.3d at 1267. The most well-known fraud in the inducement False Claims Act case is *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 87 L. Ed. 443, 63 S. Ct. 379 (1943). In *Hess*, the Supreme Court found government contractors liable under the False Claims Act for claims submitted under a contract that was obtained through false statements in contract negotiations. *See also, United States v. Azzarelli*, 647 F.2d 757, 758 (7th Cir. 1981) (bid rigging involving highway construction project). In *Harrison*, the court explained that in fraud in the inducement cases, courts have found False Claims Act

violations even where the defendant satisfactorily performed the work required for payment or receipt of benefits under a government contract, meeting the specifications, schedule, and the price agreed. 176 F.3d at 788 (discussing cases). "False Claims Act liability attached, however, because of the fraud surrounding the efforts to obtain the contract or benefit status, or the payments thereunder." *Id.*

This court's prior memorandum and opinion dismissed Relators' fraud in the inducement claim because Relators failed to allege facts showing that when ITT entered into the PPAs, ITT had no intention of complying with the provision on incentive compensation. (Docket Entry No. 64, p. 34). Relators now allege the following:

> ITT and Champagne fraudulently induced the Agency into paying Title IV, HEA Program benefits by entering into eighty-seven (87) PPAs with which they never intended to comply. ITT's ongoing practices were inconsistent with the promises made in the PPAs. ITT's practices of paying incentive compensation to its admissions representatives were inconsistent with its assertions in the PPAs, and indicate that Champagne and ITT had no intention of complying in the future with those requirements.

(Docket Entry No. 65, P41). Relators argue that the relevant intent may be inferred from "repeated unfulfilled promises." (Docket Entry No. 82, p. 17). However, the mere fact of nonperformance does not state a claim for fraudulent inducement. *United States v. Shah*, 44 F.3d 285, 293 n.14 (5th Cir. 1995) (holding that "there is no inference of fraudulent intent not to perform from the mere fact that a promise made is subsequently not performed"). The courts have emphasized that promissory fraud is a "rare" basis for

liability under the False Claims Act. *Hopper*, 91 F.3d at 1267.

Relators rely on the "strong circumstantial evidence" of defendants' "reckless or conscious behavior"--namely, the "concealment from the Agency of the uncertainty about compliance." (Docket Entry No. 96, pp. 11-12). Relators point to a disclosure made in ITT's Form 10-K as demonstrating "knowing concealment" from the Department of Education. The disclosure first appeared in ITT's Form S-1 filed when ITT made its initial public offering. It states:

> We believe that our method of compensating persons and entities engaged in student recruitment, admission or financial aid awarding activity complies with the requirements of the HEA. The regulations do not, however, establish clear guidelines for compliance, and we cannot assure you that the DOE will not find any deficiencies in our present or former methods of compensation.

(Docket Entry No. 14, P32).

The disclosure in the Form 10-K filing does not support an inference of fraud in the inducement from ITT's execution of the PPAs. The Form 10-K states that the compensation regulations do not establish clear guidelines for compliance and that governmental approval of ITT's salary arrangements cannot be "assured." This statement does not provide a basis for showing that when ITT signed the PPAs, it promised to comply with the regulation prohibiting incentive compensation to certain personnel, fully intending to violate that regulation. Relators have failed to allege facts that would show that by entering into the PPAs, ITT fraudulently induced the

government to permit it to receive student financial aid funds. (Docket Entry No. 43, Ex. 2).

F. Relators' Allegations as to PwC's False Statements or Certifications

Relators' allegations as to PwC are broad and sweeping. Relators argue that this case raises, as a "matter of first impression," whether "the United States can hold the accounting profession responsible when the Government disburses taxpayer dollars in reliance on the opinions issued by them?" (Docket Entry No. 83, p. 7). That issue is not one of first impression, and it is not presented here. The issue on this motion to dismiss is whether in the second amended complaint, Relators have stated a claim against PwC for making false statements or false certifications of ITT's compliance with a regulatory condition for payment of a claim, in order to get false claims submitted by ITT approved and paid, in violation of the False Claims Act.

In the second amended complaint, Relators allege that PwC was aware of "uncertainty" as to whether ITT's compensation program violated the regulatory prohibition against incentive payments to certain personnel, which raised a "red flag." (Docket Entry No. 65 at P95). Relators contend that in the reports on ITT's financial statements that PwC prepared for submission to the Department of Education, PwC failed to disclose this uncertainty as to the legal status of ITT's compensation arrangements. Relators allege that this uncertainty meant that ITT faced a "massive liability to the U.S. Department of Education," which should have led PwC to issue a going concern qualification rather than a "clean" opinion on ITT's financial statements. (*Id.* at PP67-69). Relators allege that PwC's failure made its statements in its opinions on ITT's financial statements that PwC had audited

ITT's financial statements in accordance with GAAS, and that the financial statements were prepared in accordance with GAAP, false. (Docket Entry No. 83, p. 2). Relators allege that PwC failed adequately to consider the legality of ITT's salary program, failed to conduct a sufficient inquiry into whether such conduct was illegal, such as hiring a lawyer, and failed to report its own questions about the legality of the program. (*Id.* at PP72-73).[7]

To participate in the Title IV, HEA programs, ITT was required to have an outside auditor perform compliance or attestation examinations and examinations of the financial statements. PwC conducted its examinations under the Government Auditing Standards issued by the Comptroller General and under the Audit (Attestation) Guide of Federal Student Financial Assistance Programs at Participating Institutions and Servicing Institutions, issued by the United

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[7] Relators allege that:

> PW failed to evaluate the materiality of the illegal compensation practices that came to its attention, and failed to consider "both the qualitative and quantitative materiality" of the illegal conduct. PW knew, or alternatively was reckless for failing to know, that ITT's illegal practices had a direct and material effect on amounts presented in the financial statements, and that the conduct had not been properly accounted for or the liability to the Agency disclosed in the financial statements as required under AU § 317.

(*Id.* at P 72).

States Department of Education. The Audit Guide included a section on the auditor's examination of Institutional Eligibility and Participation. This section required examination of the management assertion letter stating that the institution had complied with the eligibility and participation compliance requirements of the Title IV programs, including the prohibition on making commission, bonus, or other incentive payments based on success in securing enrollments, student financial aid, or student retention. The Audit Guide instructed the auditor to "test payroll and other disbursement records." (Docket Entry No. 73, Ex. P, pp. II-3, 4, and 7).

Relators point to language from the SFA Audit/Attestation Guide, which requires an engagement letter between ITT and PwC to include a "statement that both parties understand that ED [the Department of Education] intends to use the [auditor's] report to help carry out its oversight responsibilities of the Title IV programs." (Docket Entry No. 65, PP 23-24). However, this does not establish that PwC submitted a false statement or certification to get a false or fraudulent claim submitted by ITT paid.

Each of PwC's Report of Independent Accountants on ITT's financial statements contained language stating in relevant part as follows:

> In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of ITT Educational Services, Inc. and its subsidiaries ... and the results of their operations and their cash flows for each of the three years in the period ended ... in conformity with accounting principles generally accepted in the United States.

> These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States and Government Auditing Standards, issued by the Comptroller of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation.
>
> In accordance with Government Auditing Standards, we have also issued our report dated ... on our consideration of the Company's internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

(Docket Entry No. 73, Ex. E). That separate report on compliance and on internal control based upon the audit of financial statement, referred to in the last sentence, included the following statement:

> As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests on its

> compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts ... However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

(*Id.*, Ex. J). PwC attached its financial statement reports for 1995 through 1999 to its motion to dismiss. (Docket Entry No. 173, Exs. F-J).

The specific language of PwC's audit reports on ITT's financial reports do not, contrary to Relators' allegations, make false or fraudulent statements under the False Claims Act. The audit reports state clearly that PwC is not providing a legal opinion on ITT's compliance with the regulatory or statutory requirements of the Title IV, HEA program. The reports are limited to an examination of historical financial statements. The reports clearly do not include opinions as to ITT's future financial condition, the likelihood of continued eligibility for HEA funding, or any statement about ITT's future viability as a going concern.

Relators argue that the second amended complaint alleges that ITT's financial statements were inaccurate, because ITT had a "massive liability" owing to the government that the financial statements did not reveal. The liability is apparently that if ITT is found to have violated the incentive compensation regulations, it may be ordered to return the student financial aid funds it received in breach of its contract with the government. (Docket Entry No. 107, p. 3).

However, Relators have failed to allege facts showing that for the period of the historical financial statements PwC audited, ITT was under a "massive liability" owing to the government.

Relators argue that PwC was under an obligation to include in the reports on ITT's financial statements the disclosure that was part of ITT's Form 10-K, filed with the Securities & Exchange Commission. Relators assert that PwC should have disclosed in the audit reports ITT's inability to offer "assurances" of future Department of Education approval of the salary compensation arrangements. Relators do not explain how ITT's acknowledgment in its Form 10-K of the lack of clear guidelines for the regulation governing incentive compensation equates to a requirement that PwC issue a qualified or adverse opinion on ITT's financial statements. Relators do not explain how ITT's acknowledged inability to assure future Department of Education legal action approving the compensation system equates to a requirement that PwC should have issued a qualified or adverse opinion on ITT's historical financial statements. Nothing in the Form 10-K shows that ITT or PwC knew that the Department of Education would definitely find that the compensation system violated the regulations. Nothing in the Form 10-K statement makes PwC's statement of the scope or results of its audit false.

PwC tested ITT's payroll and other records as part of the audit, to determine whether they supported ITT's financial condition, as reflected in the financial statements and to determine whether there were instances of noncompliance that had to be disclosed under the Government Auditing Standards. PwC clearly stated that it did not express an opinion as to whether ITT had in fact met all the regulatory requirements imposed under the Title IV, HEA program.

Relators also allege that PwC's compliance reports for the company were false statements or false certifications. Relators allege that the Department of Education regulations required PwC to audit ITT's assertion that it was in compliance with the laws and regulations applicable to Title IV, HEA programs. (*Id.* at P21). Relators allege two false statements in these reports: that PwC had "conducted attestation/compliance audits in accordance with the standards" of Title IV; and that "ITT was in compliance with the law respecting the prohibition against paying commissions, bonuses or incentive compensation to admissions representatives." (*Id.* at P42).

PwC's compliance audit letters to ITT included the following representative language:

> We have examined management's assertions that ITT Educational Services, Inc. (the "Company") complied with the specific compliance requirements listed in the accompanying schedule of Specified Compliance Requirements (pages 17-30), listed in Section II of the U.S. Department of Education's Audit Guide, ... relative to participation in the Federal Student Financial Assistance Programs during the year ended ... Management is responsible for the Company's compliance with those requirements. Our responsibility is to express an opinion on the Company's compliance based on our examination.
>
> Our examination ... included examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on

> the Company's compliance with specified requirements.
>
> In our opinion, management's assertions that the Company complied with the aforementioned requirements for the year ended ... are fairly stated, in all material respects.

(Docket Entry No. 73, Ex. O). PwC's attestation reports dated January 1996, 1997, 1998, 1999, and 2000 are attached to PwC's motion to dismiss the Second Amended Complaint. (Docket Entry No. 73, Exs. K-O). Each contains similar language.

The compliance reports are limited on their face. They state that PwC was not providing a legal determination as to ITT's compliance with specified requirements. Relators do not allege any fact that, if proven, would show that PwC failed to "conducted attestation/compliance audits in accordance with the standards" of Title IV. Relators allege that ITT's statement that it was in compliance with the regulations which include the prohibition on incentive compensation to admissions representatives or recruitment personnel, was false. However, PwC expressly stated that it was not expressing an opinion on whether ITT was in compliance with the regulatory requirements or not.

Relators have failed to allege facts that, if proven, would provide a basis for finding PwC liable for making a false claim or a false statement to get a false or fraudulent claim paid or approved by the government. Relators have failed to allege facts that, if proven, would provide a basis for finding PwC liable under a false certification theory.[8]

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[8] Additionally, Relators have failed to cite a case in which a court has adopted a false certification theory in the

G. Relators' Section 3729(a)(7) Claim

Relators also allege that defendants violated the "reverse false claim" provision of the False Claims Act. Section 3729(a)(7) imposes liability on one who "knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government." Defendants argue that Relators have not alleged that PwC made a "false statement" to "conceal, avoid, or decrease an obligation to pay or transmit money to the Government."

In *American Textile Manufacturers Institute, Inc. v. The Limited, Inc.*, 190 F.3d 729 (6th Cir. 1999), the Sixth Circuit analyzed section 3729(a)(7), as follows:

> [W]e hold that a reverse false claim action cannot proceed without proof that the defendant made a false record or statement at a time that the defendant owed to the government an obligation sufficiently certain to give rise to an action of debt at common law. Whatever its scope, the False Claims Act clearly

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context of a third party defendant who allegedly made the false statement. Relators' claims against PwC do not state a claim for false certification because the audit reports and compliance reports did not certify ITT's compliance with the regulation prohibiting incentive compensation as a precondition to payment. *Mikes*, 274 F.3d at 702 (holding that because statute was a condition of participation, which did not "expressly condition payment on compliance with its terms," the certifications were not legally false) (emphasis in original).

> encompasses specific and legal duties to pay or transmit money or property to the government. A defendant risks liability when making a false statement to conceal, avoid, or decrease obligations such as his prior acknowledgment of indebtedness, a final court or administrative judgment that the defendant owes money or property to the government, or a contractual duty to pay or transmit money or property to the government.

Id. at 736. The *American Textile Manufacturers* court explicitly adopted an approach taken by the Eighth Circuit in *United States v. Q International Courier, Inc.*, 131 F.3d 770 (8th Cir. 1997), in which that court held:

> To recover under the False Claims Act, we believe that the United States must demonstrate that it was owed a specific, legal obligation at the time that the alleged false record or statement was made, used, or caused to be made or used. The obligation cannot be merely a potential liability: instead, in order to be subject to the penalties of the False Claims Act, a defendant must have had a present duty to pay money or property that was created by a statute, regulation, contract, judgment, or acknowledgment of indebtedness.

Id. at 773.

These cases make it clear that a government contractor's potential liability for fines or sanctions that might be imposed at some indefinite point in the future, in some indefinite amount, is not an "obligation to pay" under section 3729(a)(7). Even if the government's sanctions for noncompliance could include the ability to sue for reimbursement of previously funded monies, that potential

does not arise to an "obligation to pay" that would support a reverse False Claims Act claim. *See also United States ex rel. Lamers v. City of Green Bay*, 998 F. Supp. 971 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999).

Relators' claim under this section against defendants fails because Relators have not alleged facts that, if proven, would show that when defendants made the alleged false statements, ITT owed the United States a specific amount of money. There is no allegation that when PwC issued its audits of ITT's historical financial statements, ITT was then under a certain obligation to pay the United States money. This court GRANTS defendants' motion to dismiss Relators' section 3729(a)(7) claim.

H. Relators' Section 3729(a)(3) Conspiracy Claim

To state a claim under section 3729(a)(3), a plaintiff must allege facts showing that "(1) the defendant agreed with one or more persons to get a false or fraudulent claim allowed or paid by the United States; and (2) one or more conspirators performed any act to effect the object of the conspiracy."[9] *Ex*

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[9] That provision reads as follows:

> § 3729. False claims
>
> (a) Liability for certain acts. --Any person who--
> ...
> (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid.

rel. Wilkins, 173 F. Supp.2d at 639. General civil conspiracy principles apply to conspiracy claims under the False Claims Act. *See United States ex rel. Durcholz v. FKW, Inc.*, 189 F.3d 542, 546 n. 3 (7th Cir. 1999).

Relators explain that the conspiracy claim was added because the attestation reports "specifically required PW to investigate and report on whether ITT was paying incentive compensation to its admission representatives." (Docket Entry No. 83, p. 5). Relators allege the purpose of the conspiracy between PwC and ITT:

> [PwC] never breathed a word to the Agency or disclosed in its compliance audit reports any concern about the legality of ITT's compensation practices for admissions representatives. Upon information and belief, PW and ITT agreed and conspired to, and did, exclude from PW's attestation reports the critical language in the Form 10-K filings that would have alerted the Agency to the illegal compensation practices, in violation of 31 U.S.C. § 3729(a)(3).

(Docket Entry No. 65, P45). Relators contend that they allege that PwC "intentionally withheld material information from the U.S. Department of Education to permit a fraud to continue. This constitutes strong circumstantial evidence that could lead to a reasonable inference that there was an agreement between ITT and PW." (Docket Entry No. 83, p. 29).

PwC and ITT point out that Relators allege an unusual conspiracy to conceal facts, by reporting them in a Form 10-K. However, the conspiracy claim fails for a more fundamental reason. This court has found that none of the False Claims Act claims against PwC or ITT state a cause of

action and must be dismissed under Rule 12(b)(6). The conspiracy claim fails as a matter of law because Relators have not alleged an unlawful agreement between the parties. *United States ex rel. Atkinson v. Pa. Shipbuilding Co.*, 2000 U.S. Dist. LEXIS 12081, 2000 WL 1207162, at *12 (E.D. Penn. Aug. 24, 2000) (noting that an "agreement to act lawfully" is "not an actionable claim for an FCA conspiracy.") (following citation omitted). "The essence of a conspiracy under the Act is an agreement between two or more persons to commit a fraud." *United States ex rel. Stinson, Lyons, Gerlin & Bustamante, P.A. v. Provident Life & Accident Ins. Co.*, 721 F. Supp. 1247, 1259 (S.D.Fla. 1989) (citing *Blusal Meats Inc. v. United States*, 638 F. Supp. 824, 828 (S.D.N.Y. 1986)).

I. ITT's Motion to Dismiss Newman's Wrongful Termination Claim

Relators allege a new cause of action under section 3730(b) for the wrongful termination of Susan Newman. Relators allege that Newman was "wrongfully terminated by ITT on February 7, 2000 in retaliation for bringing the instant lawsuit," and that ITT contacted other schools to disclose Newman's involvement with the instant litigation. (Docket Entry No. 85, PP 100-102).

In order to bring a False Claims Act retaliation claim, a plaintiff must plead facts that, if proven, would show that: (1) the employee engaged in activity protected under the statute; (2) the employer knew that the employee engaged in protected activity; and (3) the employer discriminated against the employee because she engaged in protected activity. *Moore v. Cal. Inst. of Tech. Jet Propulsion Lab.*, 275 F.3d 838 (9th

Cir. 2002). ITT contends that the Relators have alleged none of the elements necessary to state a wrongful termination claim.

ITT contends that, as a matter of law, ITT could not have known of Newman's protected conduct because the complaint was under seal until July 2001, which is almost a full year after Newman was fired. ITT argues that the only way that it could have known if Newman filed the complaint would be if she violated the court's sealing order and informed ITT. Newman makes no such allegation. Relators respond that for the purpose of testing the sufficiency of the pleadings under Rule 12(b)(6), this court should not "examine the sufficiency of relators' evidence to support their allegations," but accept them as true. (Docket Entry No. 82, p. 21).

An employee is entitled to whistleblower protection under the FCA antiretaliation provisions only if "the employer is aware that the employee is investigating fraud." *Hopper*, 91 F.3d at 1269. Newman has not alleged facts supporting her claim that when ITT terminated her employment, ITT knew that she was investigating fraud. Relators do not allege that Newman was engaged in investigative steps months before she filed the lawsuit, that formed the basis of ITT's decision to terminate her employment. Rather, Relators allege only that Newman engaged in "lawful acts in furtherance of an action under the False Claims Act." The act of bringing this suit, without more, cannot provide a basis for a claim of wrongful termination because ITT did not know of the pendency of this suit until almost a year after Newman was terminated. This court GRANTS ITT's motion to dismiss Relators' wrongful termination claim.

III. Conclusion

Three attempts to plead is sufficient. *See Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 285 (5th Cir. 1993). This court GRANTS the motions to dismiss, with prejudice, Relators' claims under the False Claims Act, for failure to state a claim. Final judgment will issue by separate order.

SIGNED on March 31, 2003, at Houston, Texas.

_____// S //_____
Lee H. Rosenthal
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-00-3028
[Filed Jan 8, 2004)]

UNITED STATES OF AMERICA,	)
ex rel. JAMES F. BOWMAN,	)
Plaintiff,	)
	)
v.	)
	)
EDUCATION AMERICA, INC.,	)
et al.,	)
Defendants.	)
	)

MEMORANDUM AND ORDER

Pending is Defendants Education America, Inc.'s, Jerald M. Barnett, Jr.'s, Pedro De Guzman, Erin J. Hinkle's, Karon J.Rosa's, Bob Seeley's and Suzette Goodman's Motion to Dismiss Plaintiff's First Amended Complaint Pursuant to Federal Rules of Civil Procedure 12 (b) (6) and 9 (b) (Document No. 26), which is directed to Plaintiff-Relator's First Amended Complaint. After having carefully considered the motion, response, reply, and the precedent established in this Court and others, the Court concludes that the motion should be granted.

Plaintiff-Relator James R. Bowman ("Bowman") brings this action against Defendants Education America, Inc.,

("EAI") , and EAI"s officers Jerald M. Barnett, Jr. , Pedro De Guzman, Erin J. Hinkle, Karon J. Rosa, Bob Seeley, and Suzette Goodman (the "individually-named Defendants"), alleging violations of the False Claims Act, 31 U.S.C. § 3729 *et seq*. Specifically, Bowman contends that EAI, a corporation that operates twenty-one vocational schools throughout the country, participated in federal student financial aid programs under the Title IV ("Title" IV") of the Higher Education Act of 1965, ("HEA") , 20 U.S.C. § 1078, *et seq*. Under these programs, the United States Government insured educational loans and made direct educational grants to students enrolled at EAI. Title IV, Part G, § 487 (a) (20) of the HEA prohibits participating educational institutions such as EAI from making commission or incentive payments to admission or recruitment personnel based on their success in securing enrollments or financial aid to students. Bowman alleges that EAI and the individually-named Defendants falsely promised in program participation agreements (PPAs) and in management compliance/attestation letters that EAI would comply with the incentive prohibition regulation, knowing that they would not, and falsely certified that EAI had complied with this regulation.

This theory of liability under the FCA, namely, the post-secondary and technical school systems receiving government-secured loans and grants for their students violate the FCA by misrepresenting compliance with the "incentive prohibition" of the HEA, has been rejected by this Court and others. United States District Judge Lee H. Rosenthal of this Court dismissed such claims by relator in *United States ex rel. Graves v. ITT Educational Services*, holding (1) that the PPA does not certify compliance and ITT's management attestation did not certify compliance with a regulation that makes the certification a requirement of payment or retention of funds; and (2) that the relators failed to allege facts that would show

that by entering into the PPA's, ITT fraudulently induced the government to permit it to receive student financial aid funds. 284 F. Supp. 2d 487, 502-04 (S.D. Tex. 2003). For these and supporting reasons, Judge Rosenthal dismissed under Fed. R. Civ. P. 12(b)(6) the relators' False Claims Act claims of false certification, fraud in the inducement, "reverse false claims," and conspiracy against ITT and its chairman. *Id.* at 502-04, 508-10. Likewise, the court in *United States ex rel. Gay v. Lincoln Tech. Inst., Inc.*, No. Civ.A. 301CV505K, 2003 WL 22474586 (N.D. Tex. Sept. 2003), dismissed claims identical to those pled in *Graves* and in the case at bar, finding that (1) the PPAs were not conditions for payment by the Government and that Lincoln therefore did not make false certification of compliance , either express or implied, as a condition of payment; and (2) that the relators failed to allege facts that would show that by entering into the PPA's, Lincoln fraudulently induced the government to permit it to receive student financial aid funds.

Because this case presents virtually identical claims arising under the same theory of liability that previously has been repeatedly rejected, the Court expressly adopts and follows the rationale of Judge Rosenthal's well-reasoned and thorough opinion. Based upon this analysis, the Court finds that Bowman's allegations of violation of the False Claims Act against EAI and the individually-named Defendants fail to state a claim upon which relief can be granted.

Although Rule 15 of the Federal Ruled of Civil Procedure provides that leave amend "shall be freely given when justice so requires." Fed. R. Civ. P. 15, permitting Bowman leave to amend his complaint in this case, would be inappropriate due to futility. *See Stripling v. Jordan Prod. Co., LLC,* 234 F. 3d 863, 873 (5th Cir. 2000) (In the context of granting leave to amend a complaint, the Fifth Circuit defines futility

"to mean that the amended complaint would fail to state a claim upon which relief can be granted."). *See also Jamieson v. Shaw*, 772 F. 2d 1205, 1208 (5th Cir. 1985). In this case, only the names are different. The complaint in *Graves* ("the *Graves* complaint") is, in all material respects, identical to the pleading in this case.[1] The attorney who represented the relators *in Graves* is also the attorney for Bowman in this case.[2] Indeed, the First Amended Complaint in this case and the *Graves* complain are both printed in the same typeface and font. A careful comparison of the pleadings in the two cases reveals that 13 paragraphs in the instant Complain are copied verbatim from the *Graves* complaint, and 26 paragraphs contain only non-material alterations (parties' names, dates, word order, synonyms, etc.) from the *Graves* complaint.[3]

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[1] The relators in Graves also sued ITT's outside compliance auditor Pricewaterhouse Coopers LLP. No outside compliance auditor is named in this suit.

[2] He was also attorney for both relators whose case was dismissed for the same reasons by the United States District Court for the Northern District of Texas. *United States ex rel. v. Lincoln Tech. Inst., Inc.*, No. Civ. A. 301CV505K, 2003 WL 22474586 (N.D. Tex. Sept. 3, 2003).

[3] The only "material" difference between the two complaints is the inclusion in the First Amended Complaint of a section entitled "Willful and Intentional Conduct." Document No. 19, at 55-58. In these four paragraphs, Bowman presumably attempts to establish that EAI and the individually-named Defendants "knowingly" violated the False Claims Act by alleging that "the concealment of the illegal compensation practices by the respective campuses was ... conceived, designed, and directed as a matter corporate policy and practice by Defendants." *Id.* at 58. According to Bowman, it was Defendants' national business strategy to implement a rigorous recruitment quota system, substantially

Before dismissing the relators' claims in *Graves,* relators had three chances to plead their claims sufficient to withstand Fed. R. Civ. P. 12 (b)(6) and 9 (b) scrutiny. The last attempt, styled "Plaintiff's Second Amended Complaint," was filed April 22, 2002, in response to Judge Rosenthals' Memorandum and Order entered April 1, 2002. In the April 2002, Memorandum and Order, which totals 52 pages, Judge Rosenthal granted leave for the relators to amend their complaint to include the allegations necessary to satisfy rules 12 (b)(6) and 9(b), noting that "[a]lthough relators have amended their complaint once, the present record does not compel the conclusion that amendment would be futile." *Graves,* Civ. No. H-99-3889, Document No. 64, at 36, 38 (S.D. Tex. Apr. 1, 2002).

Bowman has had two chances to plead his claims in this case. He filed his First Amended Complaint in this case on August 12, 2002, some four months after Judge Rosenthal issued her April, 2002, Memorandum and Order. Bowman's counsel, who represented the comparable relator in *Graves*, was therefore fully informed by Judge Rosenthal's rulings regarding the insufficiency of his allegations to withstand dismissal both in that case and, because this is its cookie-cutter copy, in this case. Nonetheless, Bowman has not sought leave to amend this complaint after *Graves* was

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increase revenues, and then offer its stock to the public to the Defendants' benefit. *Id.* at 57.

Regardless of Defendants' mens rea, their alleged acts have been found by this Court not to violate the False Claims Act. Bowman's inclusion of these paragraphs in the First Amended Complaint therefore fails to distinguish it from the virtually identical action dismissed by Judge Rosenthal in *Graves*.

decided, nor has he attempted to distinguish this action from that case, nor has he made any suggestion as to how the fundamental deficiency in his theory or recovery could be remedied in this case by yet another pleading. Accordingly, because any further effort to amend would be futile, Bowman's action will be dismissed. *Stripling*, 234 F. 3d at 873; *Jamieson*, 772 F.2d at 1208.

It is therefore ordered that Defendants Education America Inc.'s, Jerald M. Barnett, Jr.'s, Pedro De Guzman's, Erin J. Hinkle's, Karon J. Rosa's, Bob Seeley's and Suzette Goodman's Motion to Dismiss Plaintiff's First Amended Complaint Pursuant to Federal Rules of Civil Procedure 12 (b)(6) and 9 (b) (Document No. 26) is GRANTED, and Plaintiff-Realtor's claims are DISMISSED with prejudice.

The Clerk shall notify all parties and provide them with a true copy of this Order.

SIGNED at Houston, Texas, on this 7 day of January, 2004.

/s/_____
EWING WERLEIN, JR.
UNITED STATES DICTRICT COURT

§ 3729. False claims

(a) Liability for certain acts

Any person who--

(1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;

(2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;

(3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;

(4) has possession, custody, or control of property or money used, or to be used, by the Government and, intending to defraud the Government or willfully to conceal the property, delivers, or causes to be delivered, less property than the amount for which the person receives a certificate or receipt;

(5) authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;

(6) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or

employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge the property; or

(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government,

is liable to the United States Government for a civil penalty of not less than $ 5,000 and not more than $ 10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person, except that if the court finds that--

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation; and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation;

the court may assess not less than 2 times the amount of damages which the Government sustains because of the act of the person. A person violating this subsection shall also be liable to the United States Government for the costs of a civil

action brought to recover any such penalty or damages.

(b) Knowing and knowingly defined. For purposes of this section, the terms "knowing" and "knowingly" mean that a person, with respect to information--

(1) has actual knowledge of the information;

(2) acts in deliberate ignorance of the truth or falsity of the information; or

(3) acts in reckless disregard of the truth or falsity of the information,

and no proof of specific intent to defraud is required.

(c) Claim defined. For purposes of this section, "claim" includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.

(d) Exemption from disclosure. Any information furnished pursuant to subparagraphs (A) through (C) of subsection (a) shall be exempt from disclosure under section 552 of title 5.

(e) Exclusion. This section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.

31 U.S.C. § 3729.

(2)

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No. 04-1204

In the Supreme Court of the United States

UNITED STATES OF AMERICA, EX REL.
DAN GRAVES; SUSAN NEWMAN,
Petitioners,

v.

ITT EDUCATIONAL SERVICES, INC.;
PRICEWATERHOUSECOOPERS LLP,
Respondents.

UNITED STATES OF AMERICA, EX REL.
JAMES F. BOWMAN,
Petitioner,

v.

EDUCATION AMERICA, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR REHEARING

SCOTT D. LEVY
Counsel of Record
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(713) 528-5409
Counsel for Petitioners

Becker Gallagher Legal Publishing, Inc. 800.890.5001

The petitioners herein respectfully move this Court for an order (1) vacating its denial of the petition for writ of certiorari, entered on April 18, 2005, and (2) granting the petition. As grounds for this motion, petitioners state as follows:

1. THE U.S. DEPARTMENT OF EDUCATION ADOPTED A REGULATION THAT DIRECTLY CONFLICTS WITH THE HIGHER EDUCATION ACT

In 2001, the U.S. House of Representatives passed the "Internet Equity and Education Act of 2001," a bill amending the recruiter compensation prohibition in the Higher Education Act. The bill inserted a revenue-based "salary" exemption and other exceptions to the prohibition against paying incentive compensation to recruiters at proprietary schools. H.R. 1992, 107TH CONG., 1ST SESS. § 484C (2001). The amendment permitted third parties and employees to participate in the revenues from an enrollment, limiting the ban to compensation "based *directly* on success" in securing enrollments [eliminating the word "indirectly" from the existing law]. The House bill passed on October 10, 2001. The companion Senate bill – S. 1445, 107TH CONG., 1ST SESS. § 484C (2001) – never came up for a vote. The amendment failed.

The U.S. Department of Education adopted regulations in November 2002 allowing the very exemptions that Congress refused to enact when it considered the Internet Equity and Education Act of 2001. See, 34 C.F.R. § 668.14(B)(22). The Agency explained in the Federal Register that the reason for the so-called "safe harbors" was because the Department of Education considered the incentive compensation statute to be redundant.

> incentive payments are now just one of several remedies in place that prevent schools from unscrupulously recruiting unqualified students.[1]

Under the Higher Education Act, proprietary schools are strictly prohibited from paying recruiters "directly or indirectly" based on the number of students they enroll. The U.S. Department of Education circumvented Congress on the incentive compensation issue. The U.S. Department of Education has effectively legalized the conduct directly prohibited in the Higher Education Act.

2. THE U.S. DEPARTMENT OF EDUCATION ANNOUNCED A POLICY OF NON-ENFORCEMENT OF THE RECRUITER COMPENSATION STATUTE

In a memorandum dated October 30, 2002, the U.S. Department of Education announced a new policy "to view a violation of the incentive compensation prohibition as not resulting in monetary loss to the Department." The U.S. Department of Justice has taken the opposite position, asserting in its amicus brief that ITT's recruiter compensation violations resulted in a financial loss to the government of no less than $400 million on defaulted student loans. The Agency's practice, as reflected in the regulation and policy statement, is that proprietary schools are without liability to repay the defaulted student loans and Pell grants received while their recruiters are being compensated in direct violation of the Higher Education Act.

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[1] 67 FEDERAL REGISTER 67054 (NOV. 1, 2002).

The U.S. Department of Education has unconstitutionally overstepped its authority with this regulation and policy statement. Executive agencies, functioning as the "fourth branch of the Government," may not subvert the statutes under which they operate. The Department of Education acted legislatively, and thus unconstitutionally, by exceeding the parameters of the Higher Education Act, 20 U.S.C. § 1094(a)(20). See, INS v. Chadha, 462 U.S. 919, 967-969 (1983). Congress very directly addressed the precise conduct at issue in 2001, when it considered amending 20 U.S.C. § 1094(a)(20). The U.S. Department of Education is now refusing to fully implement the statute that prohibits the payment of incentive compensation to recruiters at proprietary schools.

The regulation unconstitutionally encroaches on the powers reserved to Congress in the Appropriations Clause. Federal agencies are bound by the terms and conditions of appropriations made by Congress. OPM v. Richmond, 496 U.S. 414 (1990). See also, Skinner v. Mid-Am. Pipeline Co., 490 U.S. 212, 259-60, 109 S.Ct. 1726, 104 L.Ed.2d 250 (1989) (recognizing Congressional restrictions placed on agency spending). Regulations passed by the DeptEdu are subject to the limitations contained in the HEA. See, California Cosmetology Coalition v. Riley, 110 F.3d 1454 (9th Cir. 1997)(holding DeptEdu regulation exceeded agency's authority). The rulemaking authority of federal agencies is confined to the parameters of federal statutes. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).[2]

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[2] Ernst & Ernst explains:

> The rulemaking authority granted to an administrative agency charged with administation of a federal statute is

Congress spoke directly to recruiter compensation in 2001. It declined to amend the law. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). Under Chevron, id., at 842-843, an unambiguous statute governs.

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. **n9**
>
> **n9** The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. [citations omitted] If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the

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> not the power to make law. Rather, it is "'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.'" Dixon v. United States, 381 U.S. 68, 74, 14 L.Ed.2d 223, 85 S.Ct. 1301 (1965), quoting Manhattan General Equipment Co. v. Commissioner, 297 U.S. 129, 134, 80 L.Ed. 528, 56 S.Ct. 397 (1936). Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b).

Id., at 213-214.

> precise question at issue, that intention is the law and must be given effect.

Chevron, id., at 842-843.

The Fifth Circuit decision cuts off the remedy of a False Claims Act suit to recover defaulted student loans and Pell grants against companies that violate the recruiter compensation statute, while at the same time the U.S. Department of Education is refusing to enforce the statute. The petition should be granted so that the False Claims Act remedies apply to violations of the eligibility requirements in the Higher Education Act.

CONCLUSION

Tuition at ITT is $35,000. Congress clearly intended to protect the students. For the reasons set forth above, as well as those contained in the petition for writ of certiorari, petitioners pray that this Court grant rehearing of the order of denial, vacate that order, grant the petition and review the judgment and opinion below.

Respectfully submitted,

Scott D. Levy
4100 Greenbriar
Houston, Texas 77098
(713) 528-5409

Counsel for Petitioners

May 13, 2005

CERTIFICATE OF COUNSEL

I, Scott D. Levy, certify as follows:

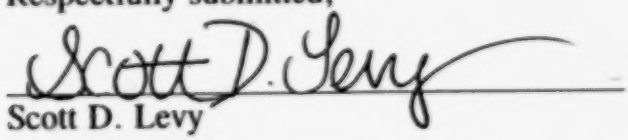
1. I prepared this Petition for Rehearing of Petition for Writ of Certiorari.

2. Pursuant to Rule 44.2 of the Supreme Court Rules, I certify that I have limited this Petition for Rehearing to intervening circumstances of a substantial; or controlling effect or to other substantial grounds not previously presented.

3. This Petition is presented in good faith and not for the purpose of delay.

Dated: May 13, 2005

Respectfully submitted,



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